MODELS OF CAPITALISM IN THE EUROPEAN UNION

Post-crisis Perspectives

Beáta Farkas

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Preface

Interest in the various institutions and comparisons of them did not wane after the collapse of the socialist system; in fact, institutional analysis has recently attracted renewed attention. Interestingly, in the literature, two particular trends can be distinguished in the analyses of institutions. On the one hand, the trend known as the varieties of capitalism (VoC) studies the institutional system of developed countries from a political-economic point of view, searching for alternatives to the neoliberal system of the USA. On the other hand, another group of researchers analyses the transition of socialist countries, searching for analogies in order to be able to classify the VoC literature or to refuse this possibility.

This book makes an attempt to empirically identify the models of capitalism found in the member states of the European Union (EU) and to elaborate a common theoretical framework suitable for all member states. Thus, not only the customary duality of the liberal versus coordinated market economy featured in the VoC literature and its fine-tuned versions but also those aspects in which the company is placed in focus are surpassed. If not only the most developed countries but also the Mediterranean and post-socialist countries are included in our investigation, the institutional systems of their economies or their operation cannot be understood without taking the role of the state into account. This approach is a political-economic one, and this comparison aims to interpret the differences existing primarily in economic performance and

competitiveness; however, the social impacts of the functioning of these models must also be considered.

The first part of the book establishes the methodological background of other studies. It provides an overview of the literature dedicated to the comparison of institutions to ascertain a place for this study in the literature.

At the beginning of this research, at the end of 2009, it was impossible to foresee the depth of the financial and economic crisis, and the subsequent developments rewrote the plan for the book. On the one hand, the classification of the models of capitalism had to be built on pre-crisis data because the indicators used to identify the institutions are modified by the temporary effects of the crisis and therefore may lead to false conclusions pertaining to the institutions. On the other hand, more than a half a decade has passed since the crisis began, and this period has been long enough to pose the question of whether the crisis triggered any changes in the models of capitalism. Therefore, the second part of the book describes the models of capitalism characteristic to the EU member states. The framework of the study has been created in a way that the results should be comparable with those of an earlier empirical study performed by Bruno Amable (2003) that included only the old member states (OMS) of the EU. The next part provides an overview of the changes that occurred during the crisis. Particular attention has been given to the course of the crisis and the regulatory responses to it; on the basis of these responses, I have tried to deduce the changes that may have a permanent impact on the institutions.

Studies pertaining to the period before the crisis and the period of the crisis have confirmed that a paradigm shift is necessary in the institutional analysis of the EU member states. A quarter of a century has passed since the system change in Central and Eastern Europe (CEE). In the meantime, countries that became member states of the EU detached from the other post-communist countries; as a result, a stable institutional system of the market economy, which has specific distinguishing features compared to the other European models of capitalism, evolved. Thus, we can speak about the CEE model of capitalism—nevertheless, a common theoretical framework can be applied to all EU member states. It is also reasonable because VoC literature has never questioned that

Mediterranean countries can be included in their research as well, under the name "mixed market economy". Nevertheless, the quantitative statistical analyses applied in this book, as well as the qualitative case studies, confirm that the institutional system of the Mediterranean countries is not more similar to that of the Nordic, North-Western countries than it is to that of the CEE countries. It further follows that the categories of the old and the new member states (NMS) no longer express the significant differences within the European integration. At the same time, there are still profound differences between the models of capitalism represented by the Nordic and North-Western countries and the models of capitalism characteristic of the Mediterranean countries and the CEE countries. Moreover, these differences can be seen in those areas that have a key role in long-term growth, in the innovation system and in the transparent and professional operation of the state and public administration. An important feature of the European social market economy is successful cooperation between employers and employees. There are essential differences between the two regions in this respect as well.

This divide is remarkably striking because in the Nordic and North-Western countries, increasing solutions serving the purpose of liberalisation were built in the Nordic and continental models of the 1960s and 1970s, while attempting to maintain the balance between ensuring competitiveness and providing the services of the welfare state. This part of the EU witnessed a certain degree of institutional convergence. The operation of the internal market and the EU regulations also had the same effect, explaining why the Anglo-Saxon model does not appear markedly in the EU. The process of hybridisation did not come to a halt even during the years of the crisis.

In addition, the crisis made it obvious to the Mediterranean countries that the precondition for their long-term development is precisely to step out of the framework of the Mediterranean model. Naturally, the effects of the reform measures taken as a response to the recession and austerity measures cannot be felt yet, but the in-depth analyses in the third part of this book reveal that the road to realisable, effective institutional solutions built on their own development path is still very long. The CEE countries' adaptation during the crisis came by way of maintaining and deepening the characteristic features of the model (liberalisation on

the product and the labour market, integration in the global value chain through foreign direct investment (FDI) and maintaining competitiveness through keeping the social protection expenditures at a low level).

This institutional analysis sends a grave message to the theory of European integration, which is elaborated in the last chapter of this book. Economic integration, as well as the monetary union, assumes the convergence of real and nominal processes among the countries. Decision makers within the EU have long been aware of the need to take action at community level in order to achieve this goal. These reforms have long been based on the conception that the institutions designed at the community level will be able to change the behaviour of the actors by combining sanctions and incentives. The difficulties that emerged due to the crisis in 2008 show that the effectiveness of such interventions is limited. The institutional analyses clearly revealed that we have to face such significant, durably sustaining differences that the question—which is never asked in the economics of the European integration—cannot be evaded: how large are those differences that allow for a still-functional internal market and monetary union? If it were possible to model this situation, we would be able to identify the minimal conditions for functionality and to estimate the related cost. When all the above factors are taken into account, we may begin talking about how these minimum conditions can be achieved and about what kind of reforms are possible and needed.

In case of the CEE countries, the European integration successfully stimulated this transition. The application of conditionality, however, was truly effective only until their intention to join the Western bloc impelled these countries and the non-recurrent, productivity-increasing effect of the transition from a planned economy to a market economy in the favourable global economic environment resulted in perceptible convergence. However, in this region, reforms have slowed down or even come to a stop in recent years. The effectiveness of the conditions and regulations imposed by the external EU level decreases, and the significance of the commitment of the given state or society increases, if productivity growth must be ensured from a higher income level and with a more complex adaptation process.

Ultimately, the EU must find a balance between two adverse aspects. On the one hand, the EU cannot fail to support, at the level of the

community, convergences that allow for a functioning internal market and a functioning monetary union. On the other hand, what can be realistically expected from the community-level institutions and regulations in this heterogeneous integration must be reassessed, and increased value must be given to the responsibility of the member states. We have to accept the situation in which the European integration is an open-ended system, not a process with a well-defined final state, implying "a safe haven". I argue that the differentiated integration is not a transitory deviation from the ideal situation to be achieved, but rather a method for handling the differences.

The European integration is a great asset that is threatened by several internal and external challenges. At the time this manuscript was completed, the outcome of the next act of the Greek drama was still unknown, and in Ukraine, because there is no immediate hope to settle the situation, we must regard the ceasefire agreement as a success. The crisis of the euro area and the tension caused by the free movement of labour within the Union have indicated that maintaining and developing this integration require new conceptual frameworks. This book makes an attempt to find these frameworks.

Finally, I express my thanks to Professor László Csaba and Professor Péter Gedeon for their valuable comments and advice on the manuscript.

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Part I

Institutional Analysis in Economics

1

Institutions in the Economic Thought

1.1 Historical Precursors

The thought that "institutions matter" is currently widely accepted in mainstream economics. However, a range of various ideas and approaches existed until this thought gained recognition. In order to understand the current situation, a brief historical overview is needed. Among the classical economists, Adam Smith was receptive to the historical approach, which inherently involved describing the changing institutional system. Analysing the operation mechanism of the market was only an instrument for Adam Smith to create a normative argument—based on the efficiency of the market—for a given institutional system. Screpanti and Zamagni (2005) reference the interpretation of James Buchanan, Gordon Tullock, and Friedrich von Hayek and go as far as to claim that Smith dealt with the comparison of various institutional structures. David Ricardo vigorously moved towards an abstract, deductive model, which was void of almost any historical or institutional content. John Stuart Mill, belonging to the classical school of economics, and Alfred Marshall, who gave a summary of the neoclassical trend, both returned to the methodology of Smith and combined deductive reasoning with historical description

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(Landreth and Colander 2002). However, Marshall's approach concerning the institutions did not become generally accepted in neoclassical economics, but rather the thought—which had already been present in the works of the "founding fathers" (William Stanley Jevons, Carl Menger,[1] and Léon Walras)—that economics studies the universally applicable laws concerning the allocation of scarce resources among alternative uses. It is well known that this brief definition of the subject of economics was polished to perfection by Lionel Robbins in his book titled *An Essay on the Nature and Significance of Economic Science* in 1932.[2] In this system of thought, the aim and motivation of human action are exogenous features built on the *a priori* axiom of rational thinking and profit maximisation. The legal and institutional environment in which decisions are made is also considered exogenous. For Marshall, it was important that his theory provide answers to the questions of economic reality that are relevant in economic policy. The impact of his approach has faded in this respect, however. In neoclassical orthodox economics, Walras' legacy—which was preoccupied with the internal logic of the equilibrium models—proved to be more powerful. Positivism, the main philosophical, epistemological theory of the era, also fostered the view that theory enjoys certain autonomy as opposed to reality. Pursuant to this approach, the validity of the assumptions of a model is less important than the model's ability to forecast. This view did not leave much room to take institutions into account (Henley and Tsakalotos 1993).

Neoclassical economics gained ground in Britain and France, but not in Germany, and it was met with resistance in the USA. Schools both in Germany and the USA placed importance on the study of institutions.

In Germany, even the classical Anglo-Saxon political economy failed to win acceptance. The main characters of the old German historical school (Wilhelm Roscher, Bruno Hildebrand, and Karl Knies), which existed in the less developed, fundamentally agrarian German economy, refused that an economic theory that was valid for the industrialising British economy would be equally valid independent of time and space. According to them, economics, as a social science, must be historically well-founded. It was exactly for this reason that they rejected the attempt of the classical school, especially Ricardo and his followers, to adapt the methodology of physics. The second generation of the German historical

school, with its outstanding leader, Gustav von Schmoller, also denied that economics possessed universal laws that would be independent of all historical, social, or institutional contexts. Thus, it is not surprising that the models of Menger, Jevons, and Walras built on marginal analysis and abstract deduction could not take effect in the 1870s (Landreth and Colander 2002; Spiegel 2004).

The German historical school did not develop an alternative economic theory with long-lasting effects; nevertheless, it had a direct influence on American economic thought. At the turn of the nineteenth century, it was not unusual for American students to go to Germany to obtain doctorate degree in economics; thus, several American university professors had gathered experience in Germany. This effect was added to other influences and effects within the USA; consequently, the old institutional school was born. There are essential differences between the views of Thorstein Veblen, Wesley Clair Mitchell, and John Rogers Commons—just to mention the three most frequently featured authors in the history of economic thought—but they share some common ideas, which have relevance to my study. Pragmatism—more precisely, the views of John Dewey—exercised profound influence on American social science and on the institutionalists. This philosophical tradition rejected natural law, the existence of universal social laws and the abstract, deductive argument in social sciences. Instead, it turned towards experience and evolutionary change. In addition to Darwin's evolution theory, the profound, dynamic economic growth and structural changes that were so characteristic of the USA at the end of the nineteenth century made scholars open to these views.

The institutionalists did not attempt to find an equilibrium deriving from a static comparison—as the neoclassical economists did—but rather wanted to explain the dependence of the economic setting and behaviour on other circumstances. In contrast with the German historical school, these scholars were not so much interested in the historical dimension of this dependence, but rather in the interaction of the economic setting and the wider social environment and institutional framework, that is, its social embeddedness. German institutionalists also dealt with the latter in a national framework, while American institutionalists concentrated on the local communities, which is only natural if we consider their historical backgrounds. Empirical data collection was deemed

important by the Americans as well, but besides this, several representatives could not abandon the idea of theory building. Moreover, the lack of theory building caused them to criticise German historism (Djelic 2010; Spiegel 2004; Ekelund and Hébert 1997; Screpanti and Zamagni 2005). American institutionalists had considerable influence between the two World Wars, but Clarence Ayres—who was member of the next generation—declared in 1944 that neoclassicism gained complete victory over the institutionalist approach (Landreth and Colander 2002: 477). The above-referenced interpretations of economic thought univocally distinguish John Kenneth Galbraith and Gunnar Myrdal as scholars who dealt with institutional analysis after the Second World War (WWII), but this approach was entirely abandoned until the 1970s.

The above-referenced books on the history of economic thought regard the old and the new German historical schools as part of economic thinking and univocally speak about old or American institutional economics when the approach of Veblen and his followers is discussed; others mention the impact of other social sciences as well. However, when historical precursors are reviewed, it immediately stands out that the study of the institutional dimensions has always been interdisciplinary from the beginning. In compliance with this, the handbook of comparative institutional analysis, which was created as an interdisciplinary undertaking, explores German historism and old institutionalism as the joint legacy of economics and political science. Based on the arguments put forward, this thought is not without reason (Djelic 2010).

1.2 Institutions in Contemporary Economics

After WWII, economic thought was no longer interested in the study of institutions, and the Keynesian economic policy based on state intervention became dominant. It seems that short-term stimulation of demand and the acceptance that market failures are handled by the state could not shake the belief in the existence of a long-term neoclassical equilibrium. This thought is expressed rather well by the neoclassical synthesis beginning with John R. Hicks, the aim of which was to fit the Keynesian system of thought into the neoclassical theory. Thanks to Paul A. Samuelson, its

formalised version found its way to education, thereby determining the way of thinking for generations (Beaud and Dostaler 1995).

In the decades after WWII, there were changes in the interrelations among the social sciences, which obviously affected institutional analyses as well. Until the 1960s, the various fields of social sciences—economics, political science, psychology, sociology, anthropology, and so on—shared experiences and learned from each other. Originating from the economics departments in the USA, several fields of social sciences began to pull away from each other. Economics became mathematised, and psychology became closer to biochemistry. Economic sociology practically disappeared in the 1950s and 1960s. In the post-war "Golden Age", it may have seemed that the Keynesian welfare state would be able to solve the social problems of developed countries (Crouch 2005).

The explosion in oil prices in the 1970s and the subsequent economic crisis resulted in a structural rearrangement in scientific scrutiny as well. Those schools based on neoclassical thought, such as monetarism and the new classical macroeconomics, basically criticised the institutional system when finding fault with the Keynesian interventionist policy. The microeconomics-based demand-side policies called for substantial institutional changes, which carried the implicit acknowledgement that "institutions matter" (Amable 2003; Pedersen 2010).

Two paradigms developed parallel to each other. On the one hand, in political sciences, one paradigm was historical institutionalism, also known as comparative political economy, which dealt with expressly economic institutional issues. On the other hand, economists and economic historians began to use the denomination of new institutional economics, new political economy, which basically meant an analytical institutionalism. In the mid-1980s, economic sociology appeared again, and according to its representatives, it immediately had fruitful interaction with new institutional economics (Nee and Swedberg 2005).

Nevertheless, if we aim to place institutionalism in contemporary economics or in social sciences, we have a difficult task. It is only natural that there is no generally accepted classification of the contemporary trends in the history of economic thought because we do not have the temporal perspective that would be necessary for such a classification. The thought that attention must be devoted to institutions appeared in a

series of contemporary approaches from the French school of "*régulation*" and from Marxists through Post-Keynesians to evolutionists (Hodgson 2007a). Therefore, it is hardly surprising that various groupings can be found in the literature or—at the other end of the spectrum—the books on economic thought often fail to address contemporary schools at all. Screpanti and Zamagni (2005) examine the contemporary trends in an even greater volume, compared to similar works, which provided an overview of economic theories, and they have collected a series of contemporary schools under the heading of institutional analysis. For instance, they include new political economy, the contractarian, the utilitarian and the evolutionary neo-institutionalism, the new "old" institutionalism, Hayek and the neo-Austrian schools. It can be seen from the above categorisation that the widespread rediscovery of institutions in economics makes the application of the institutional analysis as a group-generating, scientific-taxonomical category more or less meaningless.

We can therefore conclude—in agreement with Hodgson (2007b: 1)—that the discussion of the role of institutions in economics is commonplace today.[3] Paying attention to the institutional issues has become so general that it is no longer suitable as the basis of a scientific-taxonomic classification. It is worth making a distinction between the institutional analyses—which are also frequently performed by other social sciences (see Fig. 1.1)—and another, better defined field, institutional economics, which can easily fit into the family tree of economics as an individual approach (at the same time, naturally, it is an important area of institutional analysis, and the interdisciplinary methods are used in this as well). When we say that institutional economics is "better defined", it is only relatively true because institutional economics is a highly complex scientific branch of economics, full of contradictory and overlapping tendencies.

1.3 The New "Old" Institutionalism and the New Institutionalism

If the authors of large, comprehensive books on the history of economic theory place new institutional economics somewhere in the history of economic thought, this school—which is complementary to neoclassical

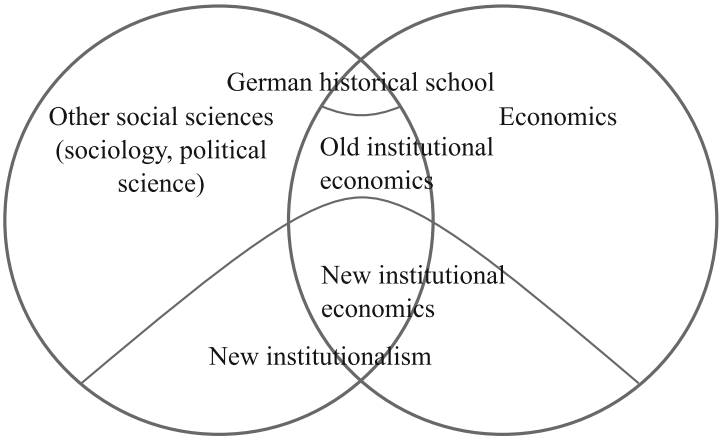

Fig. 1.1 The relationship between economics and other social sciences (sociology and political science) in institutional analysis. *Source*: Author's construction

economics and basically part of the mainstream—is usually contrasted with the heterodox old institutional economics pursued in the first third of the twentieth century (for example, Landreth and Colander 2002; Roncaglia 2007). However, old institutionalism has current representatives as well; they gained strength in the 1990s, and at present, they invariably debate with new institutionalism. Nevertheless, it is not the aim of this work to give a detailed theoretical reconstruction of these two schools. By comparing what the two schools consider the subject and method of scientific investigation, I provide an overview of those dilemmas they have to face in institutional analysis. Behind the different methodological standpoints, there are different ontological views about human beings and society.

The main forum for the representatives of old institutional economics is currently the *Journal of Economic Issues*, which was established in 1967 by the Association for Evolutionary Economics, an organisation for those institutionalists who were gradually crowded out from mainstream American economic thinking. Warren J. Samuels, Marc R. Tool, Allen G. Gruchy, Geoffrey Hodgson, and others have built on the American institutionalists of the beginning of the twentieth century. However,

this approach is not uniform, either; fundamentally, two research programmes are included. One of them is based on the Veblen-Ayres tradition and deals primarily with the industrial and business, financial dichotomy of the economy, which is also expressed in the differentiation between institutional and technological ways of thinking. This programme investigates the effect of new technologies on institutions and how social habits, conventions, and interests resist these changes. The other programme—deriving from Commons—concentrates on law, property rights, and organisations, and their development, and examines their impact on legal-economic power and the distribution of income. Institutions are considered the final outcome resulting from the formal and informal processes of conflict solving (Rutherford 1996).

The new institutional economics—the name of which derives from Oliver Williamson (1975)—involves an even more wide-ranging programme. According to the categorisation applied in the handbook written on this school, the examination of the institutions covers the state, the legal order and those macro-institutions that influence markets and companies. Other fields involve the micro-institutions that govern the companies, the contracts they conclude and the relationship between the companies and the state. Recently, in new institutional economics, there has been growing interest in the emergence, evolvement, and disappearance of institutions. According to their self-definition, new institutional economics—as opposed to neoclassical thinkers—provides the assumption of perfect information and unbounded rationality. Individuals with limited mental capacity and those exposed to uncertainties establish institutions in order to decrease risks and transaction costs. At the same time, they accept the concept of scarcity of resources and competition, but new institutional economics has its own identity, which is separate from that of neoclassical thought (Ménard and Shirley 2005).

Many researchers have joined the school of new institutional economics. If we want to name the most emblematic figures in connection with the above topics, Ronald Coase and Oliver Williamson are undoubtedly pioneers in the study of transaction costs, Harold Demsetz in property rights, and Richard A. Posner in the legal system. As far as collective action, the name of Mancur Olson must be mentioned. The economic historian Douglass North applies the instruments of new institutional

economics to provide an explanation for the different performance of the economies and their temporal changes. In new institutional economics, several authors—including Andrew Schotter—have used the game theory to explain the evolvement of institutions and their functioning. As far as the interpretation of the institutional changes is concerned, the legacy of Hayek, the new Austrian school, and Schumpeter have been mentioned in literature; moreover, other authors categorise Hayek as a new institutionalist (Hodgson et al. 1994a; Rutherford 1996).

Contemporary old institutionalists—as opposed to the self-definition of new institutionalists—emphasise the community neoclassicists share with the new institutional economics, and they are keen on markedly distinguishing themselves from new institutionalists. The contemporary pillars of old institutionalism, Hodgson, Samuels, and Tool, edited *The Elgar Companion to Institutional and Evolutionary Economics*, in which the entry comparing old and the new institutionalism was written by Hodgson (Hodgson et al. 1994a). He sees sharp differences between the two institutionalist schools in terms of "methodology" and "ontology". The differences lie in the fact that new institutionalists—similar to neoclassical thinkers—handle the preferences of the economic actors and technology as external factors, while old institutionalists consider them endogenous factors, and it is their task to explain the evolution of these factors. New institutionalists regard the individual as an atomic entity and apply methodological individualism. Old institutionalists consider society an organic phenomenon, where there is no "state of nature" in which individuals may exist without social and cultural norms; that is, they cannot be defined without institutions, thus, their methodology is institutionalist (some authors apply the term "holistic"[4]). New institutional economics—in conformity with its neoclassical roots—is interested in the optimised equilibrium conditions that derive from physical, more precisely, mechanical analogies. By contrast, old institutionalists create biologically inspired evolution theories, with the help of which they wish to provide an explanation for the continuous change of the institutions, with special regard to the role of technological changes.

New institutionalists assess the importance of the difference similar to old institutionalists, but it is only natural that what they consider a virtue is seen by the old institutionalists as a defect or a flaw. New institution-

alists hold it against the old institutionalists that they apply a holistic approach instead of individualism and behaviourism instead of the rational choice theory and that they do not attach as much importance to the spontaneous evolutionary processes in institutional development as they should but instead emphasise the collective decision-making processes and institutional design. Nevertheless, such a stark contrast between the two schools cannot be maintained after the detailed study of the authors belonging to the two approaches. In one of his later works, Hodgson (2007b: 7) himself admits that the boundaries between old and new institutionalism have become less distinct. Rutherford (1996) wrote a whole book on this topic, which is immensely informative, and below, where the key issues are introduced, we will note powerful synthesising attempts as well.

1.4 Methodological Dilemmas of Institutional Analysis

The representatives of old institutional economics rejected the orthodox, neoclassical form of theory, and model construction, declaring its programme too formal, abstract, and limited in its scope. This rejection does not mean that they refused the necessity of the theory—of which they were often accused. The methodological debate has always been about the necessary level of abstraction needed in the analysis of a complex, variable system. The complexity of the history of institutions implies a less formalised, abstract approach that comes into conflict with the expected severity of theory. The strictly formalised models lead to a simpler, idealised outcome, which may lack important elements of reality. Neither new nor old institutional economics was able to find a definite solution to this dilemma. Opinion is divided among new institutionalists in this respect: Coase, Williamson, and North do not apply formalisation, the followers of the Austrian school's traditions expressly refuse it, while those applying the game theory use it (Rutherford 1996).

A central and long-standing debate concerning the methodology of social sciences is the choice between a holistic approach and method-

ological individualism, which has been discussed extensively in old and new institutional economics.

According to the holistic approach, society is more than simply a sum of its parts, and social structures and institutions influence the behaviour of individuals, who are the functioning of society's parts. If this train of thought is pursued further, all social phenomena and attitudes of individuals may be derived entirely from or explained by social structures, institutions, or culture. The holistic approach is characteristic of old institutionalists, but usually they do not reach that extreme, reductionist level at which the action of the individual is considered merely the product of the social and cultural environment. However, they emphasise the impact of the institutional environment, norms and customs on individual behaviour. Another problem, which is even more difficult to avoid—and comes up frequently in the works of several old institutionalist authors, such as Veblen, Ayres, and Galbraith—is that the formation of norms and institutions is explained in a functionalist manner; however, these works do not describe the mechanism that actually created these norms and institutions, that is, the individual aims and incentives that led to the formation and maintenance of norms and institutions. The functionalist explanation usually postulates a purpose without a purposive actor (Rutherford 1996).

The starting point of methodological individualism is the notion that only individuals have aims and interests. Institutions, the social system, and its changes are the results of individuals' actions. Therefore, social structures and their changes can be traced back entirely to individuals' actions, goals, and beliefs. Unilateral reasoning will not hold in this case, either. Critics are correct in saying that if they want to derive the formation of institutions and norms from individual decisions—as some new institutionalist authors who apply the game theory do—it cannot be avoided that at the beginning of the game, one should assume elementary rules that would still require explanation, that is, we have to face the problem of "*regressus ad infinitum*". Thus, the reductionist solution cannot be accepted here, either (Hodgson 2007b). However, the new institutionalists who deal with transaction costs, property rights, and the legal system often make the above mistake of functionalist argumentation (Whitley 1999). The change began with North, who first explained

the institutional changes in a functionalist manner in his economic history, saying that these changes are shaped by the maximising behaviour of economic organisations. The controversies he found led him to introduce the term "path dependence", that is, historically developed institutions restrain the possibilities of institutional change; furthermore, he says that ideology has its own motivating role (North 1990, 2005).

Due to these evident difficulties, those who currently deal with institutional analysis, regardless of whether they are from the economic or the sociological side, avoid the extremes of the holistic approach and of methodological individualism. It may vary where emphasis is placed, but the starting position is the same: the individuals and the institutions mutually depend on each other and reflexively interlink. This thought has its forerunners in sociology and appears quite markedly in contemporary sociological institutionalism. Contemporary game theory also shares the view that the rules and the players create a mutually interdependent context for each other. This approach is represented rather pronouncedly by Masahiko Aoki and Avner Greif, who argue that institutions are produced and reproduced by the strategic behaviour of actors, even while actors are constrained. At the same time, institutions not only constrain actors in pursuing their material interests but also shape their cognitive capabilities and mind-set. Historical institutionalism, which has its roots in political science, also considers actors and institutions interdependent and co-generative (Hall and Taylor 1996; Jackson 2010). Representing old institutionalists, Hodgson draws attention to the "middle-way solution" in his entry about methodological individualism (Hodgson et al. 1994b: 63–67).

The issues of rational choice and rule-following are closely related to the above-detailed problems. In neoclassical economics, methodological individualism is interlinked with the assumption of rational, profit-maximising decision-making, which was thought to be universally applicable (Coates 2005). This individualism was exposed to a crossfire of attacks by old institutional economics, which holds the view that habits, norms, and institutions play an important role in directing human behaviour. This does not mean that rationality would be excluded from the interpretation of behaviour. It is not difficult to prove that maximising rationality from case to case is not realised in human decisions.

Therefore, the old institutionalists assume adaptive rationality, and customs, social conventions, and norms gradually change according to the changing conditions and circumstances. The new institutional school is more divided in this respect. Some advocates of the agency theory and the game theory represent the traditional rational maximisation, which extends over each and every case. Others are of the opinion that following customs and norms can itself be a rational decision. This decision may be justified by the costs of information and decision-making, cognitive and informational constrains, risks related to decision-making, and advantages derived from rule-following. The use of adaptive rationality is approved in this school for solving the problems of maximising rationality. Herbert Simon's theory of bounded rationality also had an effect on some of the authors (for example, on Williamson). The authors who use the evolutionary perspective (for example, Richard R. Nelson and Sidney G. Winter) expressly refuse the concept of maximising rationality (Nelson 1995; Rutherford 1996; Whitley 1999).

Schotter (1986) describes another type of intertwining between the game theory and evolutionary thought. According to Schotter, there are two trends in terms of the institutional conception within the new institutional school. One of them regards the social and economic institutions as rules, which can be designed, restrain the behaviour of the individuals and, thus, lead to a pre-determined equilibrium. Others—as well as Schotter—see the rules as unintended regularities of social behaviour emerging spontaneously in the course of repeated confrontation with the same types of social problems; in this process, Schotter assumes profit-maximising actors. Table 1.1 gives an overview of the methodological dilemmas.

In the following, I will examine the principal theoretical questions in connection with the institutions that must be clarified from the viewpoint of comparative institutional analysis. For instance, a key issue is the concept of "institution", the institutional changes, and the complementarity of the institutions. In the different views, the conflicting ideas of the old and the new schools appear, but I will place more emphasis on the trends within comparative institutional analysis. In institutional analysis, sociologists and political scientists also apply the term "new institutionalist" to themselves, that is, to those who do not use the economics perspec-

Table 1.1 The most important methodological dilemmas of institutional analyses

	Old institutionalism	New institutionalism
Methodological approach and concept of society	Holistic approach and institutions are the result of spontaneous evolution	Methodological individualism and institutions are optimised states of equilibrium
Taken as an exclusive approach	The individual is a social product: reductionism	Social system is the product of the individuals' actions: "*regressus ad infinitum*"
Synthesis	The individuals and the institutions are interdependent and reflexively interlink	
Concept of human behaviour	Rule-following: habits, norms, and institutions direct human behaviour	Rational, profit-maximising decision-making
Taken as an exclusive approach	The role of rationality is uncertain	Rational, profit-maximising behaviour cannot be applied as a general rule
Synthesis	Assumption of adaptive bounded rationality and the explanation of rule-following in rational terms	

Source: Author's construction

tive when trying to find an explanation for the mechanism and effects of institutions. These scholars call themselves historical new institutionalists (avoiding the term, "new institutional economics"), and their view of institutions is closer to the old view.

1.5 Concept of Institution

The same perceptions as those in the methodological debates can be seen in connection with the concept of "institution". A widespread definition for institutions derives from North: "institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction" (North 1990: 3). The scholars who favour the version of new institutionalism based on rational choice are inclined to accept the above definition and regard institutions as rules that are efficient and in which rationality prevails.

For old institutionalists, institutions rather meant widely accepted habits, cultural and symbolic patterns, and rationalised and impersonal prescriptions. Historical new institutionalists look upon institutions as structural frames, organisational solutions, and formal rules or systems. They attach great importance to the states and the national boundaries and frontiers in the structuration, stabilisation, and reproduction of institutional frames. Similar to the above-described methodological debates, in this case, we can see that there is an attempt to synthetise the historical and the rationalist approaches. It has been accepted that institutions became identified with the rules of the game, which provide stability and meaning to social life; nevertheless, the nature of these rules are interpreted in more dimensions. These rules can be formal and informal, normative and cognitive, and organisational and cultural, and the combinations of the dimensions vary through space and time. It has also gained acceptance that institutions do not necessarily embody efficient and rational solutions (Djelic 2010).

This comprehensive approach can be traced in the *Handbook of New Institutional Economics* as well. Ménard and Shirley define institutions in the Introduction on the basis of North and Williamson. New institutional economics studies institutions and how they interact with organisational arrangements [as North (2005: 22) puts it, "the institutions are the rules of the game and the organisations are the players"]. Institutions are the written and unwritten rules, norms, and constraints that humans devise in order to reduce uncertainty and control their environment. These include all written rules and agreements that govern contractual relations and companies; constitutions, laws, and rules that govern politics, the government, finance, and society in a broader sense; and unwritten codes of conduct, norms of behaviour, and beliefs. Organisational arrangements are the various modes of governance that are implemented by agents in order to support production and exchange. These include markets, companies, and their various combinations developed by the economic actors in order to facilitate transactions, contractual agreements that provide a framework for organising activities, and behavioural traits that underlie the chosen arrangements. Recently, representatives of new institutional economics have become increasingly concerned with mental models and cognitive processes that determine how people interpret

reality, which, in turn, shape the institutional environment (Ménard and Shirley 2005: 1).

An essential feature of the functioning of institutions is that non-compliance with the rules must be sanctioned somehow, and the method for it can vary depending on the type of the rule (for example, a sanction can be legal enforcement, social discrimination, or reprobation depending on whether the rule in question is formal or informal). In the case of the rules-of-the-game theory, the argument can be brought up in relation to those who apply the sanctions that rules also pertain to them; thus, the question arises of who enforces the enforcer. Consequently, the problem of "*regressus ad infinitum*" arises again. Aoki interprets all institutions as an equilibrium strategy in a game theoretical framework. Enforcers behave in the expected way not because of other enforcers but rather because of the strategic interactions performed by the players of the game. According to Aoki, "the institutions are self-sustaining systems of shared beliefs about a salient way in which the game is repeatedly played" (Aoki 2001: 10).

1.6 The Changes and Complementarities of Institutions

As noted above, biological evolution theories influenced the old institutional school, especially Veblen. Therefore, it is logical that the interpretation of institutional changes has an important place in theory. According to Veblen, innovations in the industrial sector demand changes in habits of thought and behaviour in the industrial and financial ("pecuniary") sectors, and this usually meets resistance. Nevertheless, institutional changes come about in the form of selective adaptation to technological innovations. Veblen places emphasis on the non-intentional, spontaneous features of the adaption process, allowing for instances of deliberate design. Institutional change is a continuous process in which institutional structures are composed of the habits of thought and behaviour that emerged from the adaptation of the community to the objective circumstances in a previous period. This process was coined "cumulative

causation" by Veblen. In contrast with the neoclassical equilibrium theories, adaptation is not necessary, social evolution is an open, not teleological, process, and its outcome is uncertain and not necessarily a state of equilibrium (Bush 1994). The views of the old institutional school can be traced in the representatives of the current, new "old" institutionalism, as well as in historical new institutional analyses.

Because the old institutional school became insignificant after WWII, interest in changes in institutions was lost as well. The modernisation theories of the 1950s and 1960s were concerned with the democratic and capitalist institutions gaining international ground. They expected "pluralist industrialism", which evolves under rational, technocratic governance as a result of the global convergence between the American and the Soviet structures. During the 1960s and 1970s, neo-Marxists wrote about how capitalist institutions would eventually be transformed into socialism. However, the 1970s brought new challenges for institutional systems to face. The Fordist model—based on mass production and consumption—began to change, the Keynesian welfare state shrunk a bit, and the economy became less regulated. Various countries could meet the structural changes differently, which aroused scientific interest in institutional reproduction, change, and comparison (Campbell 2010; Streeck 2010b).

Within new institutional economics, changes are usually explained by aspects of efficiency; due to the deliberate activity of the economic actors, institutional change is considered an efficient answer to the changes in environment and circumstances. Approaches to dealing with property rights, economic organisations and collective action, are typically in tandem with the assumption of rational choice. Authors applying the game theory—similar to the Austrian school—explain institutions as outcomes of interactions between self-interested players. This approach relates to the evolutionary and the Austrian tradition, and Hayek regards the institutional changes as evolution, which does not necessarily lead to a state of equilibrium. In particular, Hayek emphasises that changes are unintended results of individual actions and that institutions are not the result of design. The formation of social norms is not motivated by the desire to produce a social institution; only legislative processes are not spontaneous. In the functional-evolutionary explanation (based on the legacy

of Hayek), institutions are already selected at the time of their formation—following the analogy taken from biological evolution—according to whether they have a social function (Rutherford 1996).

New institutionalists from the fields of political sciences and sociology criticise economic theories, showing great propensity for coining these theories of rational choice institutionalism. In their opinion, the state and politics and values and ideologies have not been taken into account. However, as mentioned in connection with North (2005), new institutional economics has opened up to these issues as well.

New institutional analyses with no basis in economics have been categorised into several trends as well,[5] but a detailed description of these trends is not within the scope of this work. Hereinafter, the term "historical new institutionalism" will be used exclusively because it is the most frequently mentioned approach in connection with comparative analyses. Institutionalists with backgrounds in sociology and political science trace the changes in institutions to several factors. A direction of research is concerned with the diffusion of the western institutional practice, which may manifest in three different ways. Organisations may adopt normatively appropriate solutions or mime and copy the best-performing institutional practice, or it may be that international organisations coercively impose such practices on countries (Campbell 2010). However, conflicts and power struggles are considered even more important for the explanation of changes of institutions, and several economists have included this significance in their theories (for example, Amable 2003; North 2005).

In addition to the reasons why institutions change, the mechanisms of these changes and transformations are investigated as well, with special regard to the incremental changes that lead to the transformation, that is, the changes in institutions in time. Historical new institutionalists seem particularly enthusiastic about this topic. I will draw attention to those approaches that—according to the leading scholars of the school in question—are the most widespread. Streeck and Thelen, based on their observations, distinguish four types of transformations. By displacement, they mean that a new institutional model appears to replace the old one. When new institutions—which may have a transformative effect—are inserted into old ones, they speak about layering. Conversion occurs when an old

institution is redirected to serve new aims and functions. In the case of a drift, an old institution is neglected purposefully (Streeck 2010b; Thelen 2010). Campbell (2010) notes that the transformation of institutions often means that institutional principles and practices rearrange and recombine in a new and creative way, which has been termed "bricolage". If new elements are added to the existing institutional arrangement, it is termed Campbell "translation" because new elements often have to be modified in order to blend properly with the old institution. The former is similar to layering, as seen in the above categorisation, and the latter to conversion.

In order to be able to understand institutions, it is essential to have an explanation of their transformation and for their continuity. As shown above, Veblen was interested in this problem. Currently, the greatest influence is attributed to the path dependence theory of North, according to which past events and decisions appearing in institutions may persist for a long time and may restrain actors' potential decisions for the future. As in other cases, when institutional constraints are taken into account, the path dependence theory also involves the risk that actions and decisions of actors are considered predetermined. North avoids this trap; however, the change can occur in an incremental, evolutionary manner, and adaptation can begin only at the margin of the institution (North 1990, 2005). Path dependence is interpretable for evolutionist authors as well (Nelson 1995). A version of path dependence theory has developed within historical institutionalism, in which arguments taken from political science and sociology are applied to underline why institutions are resistant to change (for example, political institutions have high start-up costs, politicians deliberately introduce processes that would be difficult to change, knowledge is accumulated with the given institutionalised policy style or decision-making approach, given practices are taken for granted by the actors, and so on). Institutional complementarity and the presence of social-political coalitions are among the important explanatory factors. Some authors try to explain the changes that may emerge despite path dependence, such as situations where exogenous shocks and crises disrupt the status quo (Campbell 2010).

The study of the relations between institutions is especially important in comparing institutions. Institutionalists seem to agree that economies

are functioning in a complex institutional environment and, as a result, economic actors, if they want to make any changes, may choose from different institutional principles or practices. Nevertheless, opinion seems to be divided regarding the question of whether institutional diversity makes hybrid solutions possible, stimulates institutional innovation, or complementarity restricts the sphere of solutions, at least the efficient ones.

The second standpoint—that certain institutions complement each other and therefore occur together—is a widely accepted idea in comparative institutional analyses. Complementarity has been explained in several ways. Co-existing institutions may complement each other's deficiencies and handicaps. Others interpret complementarity as a kind of similarity. Complementary institutions encourage economic actors to show similar behaviour and reinforce each other's effects. Another consequence is that hybrid institutions show worse performance. Economists explain complementarity—by applying the game theory—in such a way that the co-existence of certain institutions creates stable models by mutually reinforcing each other. Crouch (2010) points out that the concept of complementarity has several errors. One of them is that the complementarity of institutions is often linked with economic success, but in reality, it is exactly their stability (that derives from the complementarity) that may worsen their ability to change. Another—and more severe—problem is that the number of market economies that can be compared is too small to be able to make a definite statement about the strength of interconnectedness between the institutions, and their co-existence in itself is not informative: their causal relationship and the direction of it are unknown.

1.7 The Theoretical Framework of Comparative Institutional Economics

Above, an overview has been given regarding the most important theoretical and methodological issues necessary for defining the framework in which the market economies of the European Union will be analysed

below. Because the macro-level comparison of the economic performance of national economies is the subject of the following analysis, North's (2005) approach seems the most convincing and the most productive, providing a synthesis that can be defended content-wise and that may answer methodological dilemmas as well. Let us accept that institutions are rules that are needed because human interactions occur in an uncertain world, which may reduce uncertainty in organisations' functioning. The rules for the actors are on the one hand constraints and on the other hand possibilities. North's argument is that survival is the aim of actors and organisations, which manifests in profit maximising amid competition for scarce resources. I would not go so far as to attribute universal validity to this statement—accepted as a kind of ontological condition—but in this analysis, regarding its time horizon and examining the perspectives of national economies for economic growth, I will accept this assumption as my starting point, especially because North's assumptions do not say that the decisions of the actors necessarily lead to an optimal state of equilibrium.

The knowledge and skills obtained by individuals and organisations shape how they comprehend and interpret their possibilities. The individuals who have different cultural backgrounds and different experiences may assess the same facts differently and may decide differently. This means that, consequently, bounded rationality and path dependence are assumed; it may be that development does not lead to a state of equilibrium, or it may lead to more than one possible state of equilibrium. The acceptance of path dependence does not mean determination, but rather limited choice and that changes are evolutionary and incremental. The change in the political systems in Eastern and Central Europe confirms North's (1990) observation that it takes time, even for radical changes to deepen because deeply rooted cultural legacy and the informal constraints deriving from it can adjust to the radical, rapid formal changes only slowly.

It is possible to fit this approach with the above-referenced view, according to which—in the description of the social and economic processes—the relation between the individual and the institution is grasped as interdependence, and we cannot disregard the conflicts or the power relationships.

In relation to complementarity, I could not find any correlations on the basis of which it would be possible to determine in advance whether a group of institutions will function efficiently or not. It is presumable that institutions cannot be combined at will, but we can find successful hybrid solutions described in case studies (Crouch 2010), which means that only empirical investigations may help us in finding out what the outcome of the interaction between the institutions will be.

Notes

1. The Austrian school of economics founded by Carl Menger, and especially the representatives of the second generation new school, showed interest towards the institutional issues, as will be detailed in connection with Friedrich August von Hayek.
2. "Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses" (Robbins 1932: 15).
3. In the last several decades, the approach of the mainstream economics has changed as well. Due to the problems related to the general equilibrium theory, since the 1980s, the game theory has come to the forefront of the explanation of economic interactions, which presumes the structured world of binding rules. This—as well as experimental economics—has made mainstream economics more open to institutional issues. Experimental economics no longer handles the markets as an abstract and universal forum for human interactions, but rather as a designed system of rules (Hodgson 2007b).
4. The terms "holistic" and "institutional" are not synonyms. The institutional analysis is not necessarily holistic, but the holistic explanation inevitably covers institutional factors.
5. They speak about historical institutionalism in political sciences and sociological institutionalism in sociology (Coates 2005), but historical institutionalism itself has several branches (Martin 2005). Hall and Taylor (1996) make a distinction between historical institutionalism and rational choice institutionalism within political science and touch upon sociological institutionalism as a third trend.

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2

The Models of Capitalism: Comparative Institutional Analyses

Given this overview of the most general theoretical and methodological issues related to the institutions, I will narrow down my investigation to comparative institutional analyses. Institutional research was largely neglected after World War II (WWII), but institutions started to attract attention later. The problems of the era are always reflected in comparative analyses, but their common feature is that they attempt to answer how different institutional systems promote and facilitate development, economic performance, and growth, which have been closely linked to competitiveness since the 1990s.

Similar to Chap. 1, I do not attempt to provide a comprehensive historical reconstruction of theories. My undertaking is merely to give an account of the theoretical background of those analyses focusing on the time of interest. Those works that have had an outstanding effect or influence on the development of comparative analysis will be introduced, and a detailed introduction to the current situation will follow.

B. Farkas, *Models of Capitalism in the European Union*,
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2.1 From Post-World War II Golden Age to the Crisis of the 1970s

In the 1960s, the perception became widespread—as mentioned above—that due to the generally applied technologies and the division of labour, there would be a convergence of institutional systems, namely, that models in Europe and Japan would more closely resemble the US model. Even the Eastern European socialist countries were considered part of the global process, presuming that a hybrid economy based on market mechanisms and state intervention would develop (Hollingsworth and Boyer 1997a). Researchers were also interested in how the pre-war practices of economic management changed, in what made it possible for France and the Federal Republic of Germany to catch up rapidly with the productivity level of the USA, and in the factors behind the rapid growth of the Western European countries. It seems that there is agreement in literature concerning the turning point in comparative institutional analysis, namely, Shonfield's work, which was published in 1965 (Amable 2003; Crouch 2005; Hall and Soskice 2001).

Shonfield's (1965) starting point was that the 1950s and the early 1960s saw an unprecedented economic boom in the Western European world. The persistence and the rate of growth, the wide-reaching welfare effects in Western European countries were even more favourable than those in the USA. According to Shonfield, Keynesianism does not provide an explanation because its views were accepted first in the United Kingdom (UK) and the USA, and after WWII, these countries were the least successful among the Western European countries. Shonfield finds explanations for the Western European countries' institutional changes. The most important institutional changes—according to Shonfield—include larger-scale state intervention, specifically, supervising the bank sector, establishing state-owned companies, building the welfare state, "taming" competition in the private sector (that is, by powerful regulation), developing research and development (R&D) from state resources and long-term national economic planning. He was especially interested in the latter, and in addition to information for the obvious example of France, he collected information on the various elements of planning in other

Western European countries. It is difficult to fit the Federal Republic of Germany into his theory because the country—or, personally, Ludwig Erhard—was committed to the model of social market economy, that is, the competing private economy. Shonfield notes that although the free market was propagated firmly, the cooperation between industrial companies survived, the banks' coordinating role and long-term planning appeared in concentrated, large industrial enterprises, and these features are markedly different from those of the Anglo-Saxon economies.

In the 1970s, as a result of the crisis following the oil price explosion, the question arose of what caused the post-war Golden Age and stable economic growth. The French "regulation" school sought an institutional explanation.[1] They focused their attention on five "institutional forms" of capitalism: wage and labour relations (which is the most important), forms of competition, international relations, money, and state authorities. The general form of regulation is characterised by the relationship between these forms. Post-war Fordist mass production and consumption placed wage and labour relations at the centre of attention because dividing the profit of productivity between capital and labour ensured stable employment and the social protection of the welfare state. The beneficial effect of the Fordist production system implied that the most prominent country and the regulation that prevailed in this country should be considered as an example. However, empirical studies show that the Fordist system itself changed and transformed in the various countries, and when the Fordist system of mass production came to a crisis in the developed countries; the North European countries, for instance, were more successful in introducing flexible systems while simultaneously maintaining cooperative wages and labour relations (Amable 2003; Hollingsworth and Boyer 1997a). As we will see, a prominent figure of the "regulation" school, Boyer, contributed to the debate on the social system of production in the 1990s.

In the 1970s, increasing inflation diverted researchers' attention to neo-corporatist institutions. These researchers saw the power in the agreement of the centralised corporative bodies, which were able to stop increasing prices. Peter J. Katzenstein (1985) and John Zysman (1983) continued Shonfield's historical institutionalist approach. Though they proceeded on different tracks, both of them created a

threesome typology: they distinguished the liberal economy, the state-led economy, and the neo-corporatist or negotiation-based economy. Katzenstein provided a detailed description of the latter in his influential book, in which he investigated the outstanding economic performance of the small, developed countries. His starting point was that by 1982, the per capita GDP in five European countries, including Switzerland, Sweden, Norway, and Denmark, had exceeded that of the USA.[2] This spectacular result prompted Katzenstein to analyse how the small European countries, such as Sweden, Norway, Denmark, the Netherlands, Belgium, Austria, and Switzerland, adapted themselves to the rapid changes of the 1970s. He found that these countries counterbalanced the liberalism they pursued in their international economic relations—which they were not willing to give up, although there were protectionist approaches in large states at that time—by internal policies. In the name of national income policy, they limited the increase in wages and prices. R&D expenditures increased in the 1960s and 1970s, even when these expenditures generally decreased on average in large industrial countries. Industrial policy was applied more actively for structural changes than in the USA or West Germany. Small countries usually have less diversified economic structures, are more open, and are in great need of import and foreign capital. Managing this external vulnerability is helped immensely by corporatist traditions. In these countries, feudal traditions are relatively weak; therefore, the weaker right wing was willing to reach an agreement with the trade unions and with the left wing. This legacy promoted the development of democratic corporatism after WWII. Only Austria is an exception, where social partnership after WWII became established as the result of the radical break with the past after the collapse of Austria-Hungary, the civil war in 1934 and the fall of fascism. Katzenstein's (1985) book is interesting on the one hand because he explains economic performance by the interaction of the elements of the economic-political group of institutions and, on the other hand, because comparing these elements allows him to demonstrate the comparative advantages of the national economies, which leads us to the question of competitiveness, which is the core issue of the 1990s.

2.2 Classification of the Varieties of Capitalism in the 1990s

In the 1990s, comparative institutional analyses reinterpreted the institutional systems of market economies in an environment that changed considerably in at least two aspects.

Beginning at the micro level, the Fordist production system in the economies of Western Europe, North America, and Japan was converted into flexible production systems. While the former was based on the production of highly standardised goods exploiting economies of scale, for which specialised machines and semi-skilled labour were used mainly, in the latter, various types of flexible production systems offer a wide range of products adapted to various consumer needs, and skilled workers can be moved between various jobs within the company. The Fordist system and the flexible production system are two ideal types—their appearance in reality was not so definite—but their comparison makes it understandable that several authors focus on the company and its functioning and that other elements of the institutional system are attached to it.

At the macro level, the spread of globalisation and the collapse of the Soviet Union made the question of whether countries were headed towards one single model of capitalism due to the international competition, that is, whether the market economies would converge towards the liberal market economy model of the USA after the neoliberal, neoconservative wave of the 1980s, especially topical.

2.2.1 Comparison of Business Systems

When Fordist production systems were described, there were attempts to distinguish the different forms of capitalist development in the twentieth century on the basis of different methods of corporate governance. Chandler (1990) discusses competitive managerial capitalism in relation to the USA. In the twentieth century, competitive managerial capitalism meant that the extended bureaucratic management of large corporations coordinated a wide sphere of activities and transactions, and owners were segregated from the managers, invested in R&D, retained incomes and

dividends for the sake of new investments, and expanded their activities abroad as well. In Great Britain, personal capitalism survived, where family-owned companies were dominant, less was invested in R&D, management, and marketing, and risk was reduced by corporate alliances through contractual cooperation. In the model of cooperative managerial capitalism, large German corporations were able to exploit the advantages of economies of scale and were able to expand the same way as in the USA. The production chain was integrated by the large bureaucratic management, but—unlike in the USA—supervision by the family and strong cooperation between the companies survived. The latter was facilitated by corporate financing through banks, which was not characteristic of the Anglo-Saxon practice, either. The production systems were flexible and relied on skilled labour. Germany, even though it functions differently, overtook Great Britain and became Europe's leading industrial state even before WWII as a result of its developed organisational capacities similar to those of the USA.

According to Lazonick (1993), it is characteristic of the successful capitalist economies that there is a shift from market coordination towards planned coordination within the business organisations. In the USA, those managerial structures that were able to plan and coordinate the technologies and production processes of the second industrial revolution began to develop in the 1920s. The US managerial capitalism kept its advantage until the 1960s, but Japan's collective capitalism presented an increasing challenge during the following two decades. In Great Britain, in the framework of proprietary capitalism, where economic coordination was performed mainly through market contracts, the innovation strategies were followed to a lesser extent, and they were not able to run the Fordist production system competitively.

These were the preliminaries upon which Whitley (1999) built his own sophisticated system. First, Whitley determined ideal types on the basis of the main characteristics of the business system, and he distinguished six types of them, defining their characteristics in the context of the institutional environment (state control, financial institutions, trust, and authority).

2.2.2 From the Competition of Enterprises to the Competition of National Economies

In the theories described above, business or entire economic systems were compared at a given time, the main aim or one of the aims of which was to provide an explanation for their different economic performance. In the background, we can find the intention to provide evidence for the viability of one market economy model or another, and in most cases, the rejection of the Anglo-Saxon or the American hegemony. Later, Michael Porter's book *The Competitive Advantage of Nations*, first published in 1990, had a significant effect on these types of research. Porter remains indifferent to the various models of capitalism and focuses on competitiveness. At certain points in his investigation, he attaches the various levels of competitiveness to various groups of institutions (Porter 1998); thus, paradoxically, his work became integrated into the sources of comparative institutional research.

Porter led a four-year-long international research project, during which case studies were completed about the ten major industrial countries; in these case studies, the causes of their competitive advantages were revealed from a historical perspective. On the basis of this work, Porter summarises the most important elements of national advantages, factor conditions (including the entire system of infrastructure, even healthcare and cultural institutions), domestic demand conditions, the availability and the quality of related and supporting industries and the association between firm strategy, structure and rivalry. From this list, it can be seen that Porter—contrary to the authors of the previous theories—does not examine the production systems directly, but rather expands the traditional growth factors in economics by adding the institutional dimension; additionally, he does not apply econometric modelling.

On the basis of his investigations, he does not categorise the ten countries into capitalist models but distinguishes the four stages of competitive development: factor-driven, investment-driven, innovation-driven, and wealth-driven stages.

In the factor-driven stage, the competitive advantage of a country comes from natural resources or from cheap and semi-skilled labour.

Technology comes from other countries; domestic firms only imitate them. Few domestic firms come into contact with end users. The economy is sensitive to the cycles of the global economy. All states go through this stage, but few surpass it. There are some states that, due to their ample natural resources, are able to reach high living standards in this development stage (Canada and Australia).

Large-scale industry develops in the investment-driven stage, and industry is equipped with the "latest but one" technology available in the market (latest-generation technologies are not sold). An important difference from the previous stage is that purchased technologies are developed further and that universities and research institutes are integrated into this development. The companies in this stage still compete with standardised price-sensitive products, but they appear abroad as well. Those industries are suitable for providing the economy with access to the advantages of the investment-driven stage in which the economies of scale can be exploited, but its labour cost component is also large, and the technology can be taken over in a ready state. In this stage, the economy is not as sensitive to global economic shocks, but it is still vulnerable. Porter says that few countries reached this stage: in the period after WWII, only Japan and, later, Korea. Taiwan, Singapore, Hong Kong, Spain, and, to a certain extent, Brazil show signs of having reached this stage. The investment-driven stage calls for a national consensus that favours investments and long-term growth over current consumption and redistribution of income. The government is pursuing selective industrial policy, which carries the risk that the protection of the industry does not remain temporary due to the pressure of the groups concerned; thus, industry cannot surpass the factor-driven stage.

In the innovation-driven phase, domestic firms are able to create new technologies and methods themselves, and they are globally competitive at an international level. Cost competition occurs; however, it is not built on factor costs, but rather on efficiency deriving from a high level of skills and developed technology. The manufacturing of price-sensitive products is given over to other national economies. International competitiveness extends over services as well. The economy is less sensitive to external shocks than in previous stages. The government develops the business environment in an indirect way instead of through direct intervention.

In the wealth-driven economy, the willingness of firms to bear risk is decreasing, and instead, greater effort is made to influence governmental policy in a way that is more beneficial for them. Innovations slow, and investments in industry are chronically insufficient. Domestic companies are purchased by foreign firms and integrated into their global strategy. Decreasing wages and increasing unemployment worsen the incentive to improve productivity, which causes a further loss of market shares.

The individual stages do not necessarily follow each other. Italy (more precisely, the Northern Italian regions) advanced directly from the factor-driven stage to the innovation-driven state. According to Porter, Great Britain reached the wealth-driven stage by the 1980s, and Thatcher's government turned the country back.

In Porter's theory, the advantages of the national economy are created by the home-based company. The home basis is the place (in most cases, also the headquarters) where the firm's strategy is set and where the key products, the technological processes—in a wider sense—are ultimately created. The most productive workplaces, the core technologies, and the most developed skills can be found in the home basis. The property of the firm is often concentrated in the domestic base, but the nationality of the shares is secondary. If the company remains home-based, that is, it keeps its actual strategic, creative, and technical control, the national economy gains the most profit, even if the company is the property of foreign investors or owned by a foreign company.

Porter's theory appeared among the basic sources of literature belonging to the "VoC" (Varieties of Capitalism) school (discussed below) in relation to the institutional competitive advantages (Soskice 1999; Hall and Soskice 2001) and in *The Oxford Handbook of Comparative Institutional Analysis* (Pedersen 2010). Although it has been criticised that competitiveness was elevated from the micro level to the macro level, these voices have subdued, and a wide-ranging agreement has been reached on the competitiveness of national economies (Aiginger 2006). As shown in the institutional comparative analyses providing an explanation for institutional changes, transition from one state to another is quite a methodological challenge. A great asset of Porter's theory is that the development perspective of the various economic models can be traced. He does not apply the variables of the continuous neoclassical functions, but rather

discrete, well-distinguishable stages to describe development, which fits in with the assumption of the institutional analyses, namely, that an efficient institutional arrangement requires a certain level of complementarity.

2.2.3 The "Neo-American" and "Rhine" Capitalism

Michel Albert's work—which was published in 1991 in French and in 1993 in English—had a great effect on the classification of the models of capitalism. The author was President-CEO of the *Assurances Générales de France* for more than a decade, including at the time of publishing his book. It is important to be aware of the fact that he was not a researcher by profession. His work does not contain references (with the exception of the figures), although he uses a great deal of statistical data, his work is rather a readable—and simultaneously perspicuous—essay than a standard scientific paper. His aim was not the creation of a model, but rather the criticism of Reagan's neoconservative, neoliberal economic and social policy. In his work, he contrasts the "neo-American" model with the "Rhine" model, the latter including Germany, Austria, Switzerland, the Netherlands, while the Scandinavian countries and Japan show signs of similarity. The "neo-American" model is characterised by individualism, the importance of short-term, financial profitmaking and the fact that the greatest variety of goods is available in the market (including education, healthcare services, public transport, and so on). The "Rhine" model is characterised by long-term vision, publicly organised welfare provisions, a greater extent of social equality, and consensus seeking. He considers Germany and, generally, the Rhine model—with its strict financial policy, strong currency, and large export surpluses in foreign trade—socially and economically superior to the USA, where indebtedness grew alarmingly (one must not forget that the book was published in 1991!). Notwithstanding the above, he saw that Americanism was jeopardising the Rhine model, that the concept of social market economy was unknown even in the spheres of the trained economists and that the Eastern and Central European new democracies were bedazzled by the glamour of American capitalism. Changing habits and demand, strengthening of individualism, and demographic decline all undermine

the basis of the Rhine model. Albert aimed to end this process in Europe. He does not even bother with categorising the other Western and South European countries with the help of a theoretically elaborated classification system. At the same time, his work contrasting the American and the Rhine models has had a considerable effect, and it is considered the forerunner of dual classification, and his term "Rhine model" has become widely used.

2.3 The Dichotomy of the Liberal and the Coordinated Market Economies

Peter A. Hall, political scientist, and David Soskice, economist, published their volume of studies titled *Varieties of Capitalism. The Institutional Foundations of Comparative Advantage* in 2001. In its introduction, they elaborated a new theoretical framework for the survey of developed national economies. Their undertaking was successful, their approach has become one of the most popular in the literature, and the school of VoC is frequently cited in connection with them. As demonstrated above, as Fordist mass production declined, the examination of the social system of production—to a large extent due to the influence of sociologists—assumed a very important role in the works of institutional comparison, with special regard to the behaviour of the companies and the coordination of their activities. Hall and Soskice place their approach in this trend as well. They point out that, in addition to Albert (1993), the work of Hollingsworth and Boyer (1997b), Crouch and Streeck (1997), and Whitley (1999) had great influence on them.

These authors examine the most important spheres in which firms must develop relationships, such as corporate governance (including funding), industrial relations, the system of vocational training and education, inter-firm relations (including relations with the suppliers and customers), and coordination vis-à-vis employees. These are the same as the elements in the study of Hollingsworth and Boyer (1997a); the only difference is that the latter also list the conception of fairness and justice held by capital and labour, the structure of the state and its policies,

and a society's idiosyncratic customs and traditions, as well as norms, rules, and laws. This difference can be attributed to the fact that Hall and Soskice follow the tenets of new institutional economics (in which institutional analyses are built on rational choice) in their theoretical framework related to institutions. This approach manifests in their starting point, which is built on individual and rational choice, which is complemented by taking culture, values, and historical features into account. The definition of institutions is expressly taken from North, economic actors are at the centre of these authors' political economy, and the authors presume that these economic actors follow their interests rationally through their strategic interactions with others. According to this view, the major economic actors are companies, and their ability to adapt over the course of technological changes in international competition is of crucial importance. Hall and Soskice focused their investigations on companies' above-mentioned system of relations, while also noting that, in addition to formal institutions, culture, informal rules, and historical experiences also have a very important role. These authors apply the micro-level interpretation of organisations' behaviour to understand macroeconomic problems; that is, they integrate the analysis of corporate behaviour with that of political economy. They suggest that the differences in the socio-economic institutional system cause systematic differences in corporate strategies and in the two ideal types of market economy: liberal and coordinated market economies. It is not declared expressly, but their study implies that in the relation between the individual and the structure, the authors aim to avoid reductionism in both directions, thus assuming a dynamic interaction.

These authors find that there is a close relationship between the coordination type of companies' activities and institutions. Based on the coordination of economic activities, they describe the two ideal types of modern capitalism: the liberal market economy and the coordinated market economy. The difference between the two types is reinforced by the presence of institutional complementarity. These authors follow Aoki by considering two institutions complementary if the presence (or efficiency) of one increases the returns from (or the efficiency of) the other. When the two ideal types are introduced through the cases of Germany

and the USA, the authors give a detailed account of how the institutional solutions of certain individual areas may assist each other.

In coordinated market economies, access to the financing is not entirely dependent on current returns. Because firms have access to "patient capital", they are able to retain a skilled workforce even at times of economic downturns and to invest in projects that generate returns only in the long run. Investors obtain information for the assessment of a firm by virtue of professional relationships, from the extensive networks of cross shareholding and through active industry associations (chambers and so on), which means that the firms are under "network reputational monitoring". Because firms often fund their activities from retained earnings, they are not as sensitive to external financial conditions; on the other hand, they are sensitive to hostile acquisitions, against which the relevant provisions of law offer protection. Top managers of these firms have to negotiate with many actors (major shareholders, employee representatives, major suppliers and customers, and so on), and managerial incentives also stimulate them to reinforce the operation of business networks. The rights of the trade unions and works councils present a further need for agreement in labour relations. In vocational training, employer organisations and trade unions supervise the publicly subsidised system of vocational training and apply pressure on firms to take on apprentices in the framework of apprenticeship schemes. These actions are beneficial for the firms because employer associations prevent skilled workers having received industry-related and corporate-specific knowledge from being poached by competitor firms. In addition to long-term employment contracts, the main source of technological transfer is not the movement of scientific and engineering personnel, but rather firms' network of relationships supported by business associations. To maintain the latter, formal contracts are not enough; informal standards and customs are necessary as well.

In the liberal market economy, financing resources are dependent on current earnings and the price of shares on equity markets. Regulatory regimes are tolerant of hostile acquisitions, and no close-knit corporate networks develop. In industrial relations, there are market relations between the individual employee and the employer, it is not a requirement to set up work councils, and the role of trade unions is more

limited than in the former case. Limiting the attempts to increase wages, thus, depends more on economic policies and market competition than on wage bargaining pursued with trade unions. The decision-making authority of firm managers is concentrated on the top management; therefore, the dismissal of employees in order to take advantage of new opportunities is easy. Vocational training is performed within the framework of a formal education system where general knowledge and skills are developed. Firms are reluctant to invest in apprenticeship schemes because trained, skilled workers are easily poached. The flexible labour market also encourages employees to obtain skills that can be generally used. Inter-company relations are based on enforceable formal contracts. Technology transfer is secured through the movement of scientific personnel from one company to another. Licensing and the sale of innovations provide another important channel for technology transfer.

Hall and Soskice also describe in detail why the above systems of institutions make liberal market economies more suitable for radical innovations, while coordinated market economies for incremental innovations. Nevertheless, they do not claim that any of the systems is superior to the others. Rather, institutional differences determine those areas and fields—in an international spectrum—in which the given system can achieve a comparative institutional advantage because certain fields are characterised by incremental innovations (for example, machinery), while others by radical innovations (for example, biotechnology and software development).

The authors' investigations are centred on developed countries; however, they say that this dual system can be applied to study developing countries as well. Among the Organisation for Economic Co-operation and Development (OECD) nations, the positions of six countries—France, Italy, Spain, Portugal, Greece, and Turkey—are not so evident. The authors find it possible that these countries constitute another type of capitalism, the "Mediterranean" type, with a large agrarian sector and extensive state intervention enabling them to have specific capacities for non-market coordination in the sphere of corporate finance and more liberal labour relations. They also point out that not all economies correspond to the two ideal types.

In their opinion, globalisation exerts huge pressure on national economies, which may adversely affect the institutional system of the coordinated market economies; nevertheless, this does not necessarily lead to institutional convergence, either.

Their conception has sparked intense debate, but before going into this topic, let us take a quick look at the study by Peter A. Hall and Daniel W. Gingerich (2004). The approach of Hall and Soskice almost entirely lacks aggregate and empirically founded investigations. Hall and Gingerich implicitly intend to remedy these shortcomings and complement the argumentation based on comparative case studies with an empirical test. Because they consider coordination to be a central category, they collect those statistically accessible variables that are suitable for identifying the type of coordination. They construct a coordination index and apply it to national economies with the help of factor analysis, proving that there is a fundamental difference between market coordination and strategic coordination. The complementarity of the institutional areas is another central tenet that should be tested empirically. Hall and Gingerich assume that the reason why complementarities occur is because they have proved to be efficient. They find seven spheres, among which they identify several complementarities. Based on these spheres, they confirm by various econometric methods that complementarity has a positive effect on economic growth in the case of three relations—for example, between corporate governance and industrial relations. It follows from the foregoing that purely market coordination and purely strategic coordination both have more beneficial effects on economic growth than mixed solutions. The relation between the rate of economic growth per capita in the OECD nations between 1971 and 1997 and the type of coordination confirms this assumption. Finally, these authors also explore whether institutional changes are heading towards convergence and whether coordinated market economies begin to adjust to liberal market economies. They compare indicators from the period between 1980 and 1990 that are characteristic of certain institutional areas. The Mediterranean countries and France are handled as mixed market economies in a separate group. In sum, coordinated market economies have taken moderate steps towards liberalism, and there have been changes in

the field of strategic coordination, but we cannot talk about large-scale convergence.

2.4 Dual or Plural Classification?

The theory of Hall and Soskice has attracted immense attention, as noted by the researchers of this topic (for example, Nölke and Vliegenhart 2009; Streeck 2010a). Hall and Soskice's interpretation had its followers; however, it generated considerable debate as well. In the following, I will examine the important nodes of this debate—without the exhaustive review of the related literature—to clarify the theoretical framework of my research topic.

Without question, the most univocally debated and criticised issue has been the dual classification of market economies into liberal and coordinated market economies. Although Hall and Soskice (2001) point out that the Mediterranean countries may constitute another type of capitalism, this notion did not gain significance in their study. The authors' terms are not entirely logical, and several authors have drawn attention to this. The liberal market economy is coordinated as well, but typically through market interactions, and the coordinated market economy is coordinated not through market interactions but—as Hall and Gingerich (2004) subsequently describe—through strategic coordination.

According to Hay (2005), the foundation of the dual classification is not clear. In conformity with Hall and Soskice's institutionalist approach based on rational choice, two models of capitalism are built on the dichotomy of market—non-market coordination by applying deductive reasoning. However, Hall and Gingerich (2004) use an inductive approach, and empirical evidence does not support duality. There is no reason why we should not distinguish, for example, the continental countries, the Nordic countries, and so on. When the archetypes (Germany and the USA) are compared, the liberal market economy seems to be an "institution-light" system—it is like a residual category. However, in their case, it is not about the lack of coordination—they are coordinated in another way.

Pontusson (2005) points out not only that the "hybrid countries" indicate the cumbersomeness of the dual classification but also that Japan does not fit into the category of the Germany-based coordinated market economy. Moreover, Great Britain, with its developed welfare provision, does not fit into the US-based liberal market economy.

While Hay (2005) believes that there is a micro-economy-based institutionalism behind Hall's dual system, Crouch (2005) sees the economic version of the neoliberal-social democratic political philosophical theories in the two models. Crouch criticises the dual classification because he finds that the models and empirical data are not compatible—France and Great Britain, for example, do not fit into this duality. Crouch goes even further, saying that the USA does not appropriately represent the characteristics of the liberal market economy and that Germany is not suitable for representing the coordinated market economy. In the Unites States, the scientific and technological innovations deriving from the military sector have great importance for the economic performance of the country. Another factor is that in the 1990s, the countries that entered the information technology market first gained a huge advantage, which was coupled with the advantages resulting from the size and the international position of the country. However, all these reflect the results of the intra-company and state coordination, not those of market coordination. Lazonick (2007) argues that the advantages of the USA originated from corporate hierarchy and not from market coordination in the "old" business model of the decades after WWII and in the business model adjusted to the new economy (propelled by information technological innovation) of the 1990s.

Regarding Germany, Crouch (2005) notes that considering that Germany is a federal state, state coordination and the network relations of the actors are looser than in the small states; thus, Germany should be considered rather an outlier case of a coordinated market economy than a paradigmatic example of it. This is in sync with the assessment of Katzenstein (1985), who suggests that Germany is the closest to the democratic corporatism of the small states but that Germany has much stronger market elements.

Amable (2003) argues against the dual classification by saying that classification according to one dimension only (coordination) does not reveal

much about why one country is put into the same category as another country. If the number of intermediate, "imperfect" cases is high, a classification more complex than the dual classification has been disregarded.

It can be seen that irrefutable counter-arguments have been put forward against the dual classification. As a matter of fact, it is difficult to understand why Hall and Soskice insisted on this classification because the problems of dual classification had come to the surface even before their paper was published in 2001. Soskice introduced this duality in several of his papers at the beginning of the 1990s (Hall 1999); in 1999, he wrote about uncoordinated or liberal and business-coordinated market economies (Soskice 1999). The volume in which this paper was published (Kitschelt et al. 1999b) has also attracted much attention. Although in the final study (Kitschelt et al. 1999a), the editors committed themselves to the classification made by Soskice, they described four types of capitalism, connecting them to various political arrangements. In addition to uncoordinated liberal market capitalism, they distinguish the national coordinated market economies (the Nordic countries), the countries with sector-coordinated market economies, that is, countries of "Rhine" capitalism, and group-coordinated market economies in the Pacific basin (Japan, Far East).

The book edited by Hancké et al. (2007b) aims to apply the VoC approach to the current issues of the EU (functioning of the EMU, the Eastern European nations' accession to the EU). In the introduction to this volume (Hancké et al. 2007a), on the one hand, the authors expressly reject those critical comments and observations made in connection with the conceptual framework of Hall and Soskice. On the other hand, based on these critics, they wish to develop it further. One such accepted modification was the review of the dual classification.

Authors criticise dual classification, believing that more models are necessary for the interpretation of contemporary capitalism. Furthermore, others who question whether states enjoy enough independence in today's global economy such that models can be built on national economies. Crouch (2005: 42) expressly declares, "theorists of the diversity of capitalism are eager to play down the implications of globalisation, and argue intelligently and forcefully against the naive assumptions of much other literature that globalisation somehow abolishes the significance of

national differences". Streeck (2010a) draws attention to studies according to which there is institutional arbitrage, that is, due to the free international movement of capital, firms are able to choose the institutional environment that best fits their needs. Hall and Soskice (2001), though recognising this notion, conclude that diversity between countries can be retained because the differences in national institutional frameworks may present various competitive advantages. According to the studies to which Streeck (2010a) makes reference, institutional arbitrage redounds on the practice pursued in the country of origin and, as a consequence, it may increase institutional diversity within the country while decreasing diversity between countries. It is worth noting the differences in coordination at the national, regional, and sectoral levels.

Regarding state, this issue is not the only problem with Hall and Soskice's interpretation. Although Hall and Soskice connect their models to various states, the role of the state is missing. In other classifications (see below), the state-led market economy itself is one of the models. This deficiency is recognised by Hancké et al. (2007a), and in the same volume, Soskice (2007) investigates how production regimes are complementary to welfare state regimes and political systems, maintaining the dual classification of the market economies into liberal and coordinated market economies.

Regarding the question of institutional changes and complementarity, the debate in connection with the work of Hall and Soskice (2001) (which has been mentioned above on a general, theoretical level) flares up again. Undoubtedly, these authors rely on the thought of complementarity quite strongly and conclude—partly based on this complementarity—that in spite of globalisation, national characteristics are retained because the changes in the institutions disturb the efficient cooperation with the complementary institutions. The changes, therefore, should be accomplished in the form of gradual adjustment.

It is worth considering a counter-argument concerning complementarity represented strongly by Crouch (2005) and confirmed empirically by Streeck (2010a), namely, that hybrid institutions can be viable as well. This argument also demonstrates the limitations of empirical evidence because Hall and Gingerich (2004) empirically confirm the efficiency-increasing power of complementarity and the weaker performance of

hybrid solutions. However, according to Crouch (2005), the heterogeneity of institutions is downright preferable because if a development path is blocked, those actors who are able to find a way out with the help of their alternative strategies are present.

In the background of the issue of complementarity and change are the questions of whether globalisation facilitates institutional convergence or divergence and of whether coordinated market economy remains a viable alternative for Anglo-Saxon, or, rather, American, capitalism. Pontusson (2005) accuses Hall and Soskice of tackling this question rather briefly and obscurely. In his criticism, it is quite illuminating when he demonstrates that revealing convergence or divergence between the two models depends largely on the indicators chosen. For instance, in coordinated market economies during the 1990s, there is no decrease in the index—applied by the OECD—measuring the protection of the employees, which means that the differences between the models remained. However, if we add the increase in the number of employees with open-ended contracts—who are not covered by this protection—the picture is somewhat different: the labour market of the coordinated market economies converges towards the liberal one. In a similar period, wage inequalities increased to a greater extent in the liberal market economies than in the coordinated market economies—as expected on the basis of theory—but if the change in the household income of the working age population is measured by the Gini coefficient, we cannot find a clear correlation between the type of economic coordination and the increase in inequality.

Political scientists and sociologists criticise Hall and Soskice, arguing that economic coordination as a single dimension is not enough to explore the variations of capitalism, and they object that power relations, class interests, and conflicts have not been taken into account. For example, Pontusson (2005) suggests that coordination should be complemented with a second dimension, namely, whether class compromise has been institutionalised or not. Thus, for instance, the differences between pre-Thatcher Great Britain and the USA would be manageable, while the common characteristics of liberal economic coordination are maintained. Streeck (2010a) completely refutes their theory; according to him, Hall and Soskice, as well as the entire approach, show the types

of neoliberal capitalism at the end of the twentieth century under the term VoC, although their common features and their interdependency are more important than the differences between them.

Boyer (2005a) sheds light on the weaknesses of VoC from the viewpoint of the "*régulation*" school. He does not accept the dual classification; moreover, he does not find the economic coordination approach satisfactory, either. According to Boyer (2005a), there are four polar principles in terms of coordination (market, firm, state, and community), and the entire VoC literature covers only some of these principles. He underlines the importance of labour market institutions and welfare systems, claiming that their inclusion is not enough—they must be the centre of attention. These critical views originate from the principle tenets of the "*régulation*" school and can just as well be subjected to criticism as the statements of VoC. It is interesting how Boyer sees the difference between the two schools concerning the interpretation of change. VoC interprets the changes as adaptation to external shocks, with the help of which the essence of the institutional infrastructure can be maintained. The "*régulation*" school often considers crises to be the consequences of prior success and emphasises the internal, endogenous development of the economic system. Nevertheless, Boyer (2005a) finds it important that the two schools cooperate closely because, despite the above differences, there are similarities between them.

Mjøset and Clausen (2007) raise methodological problems in connection with the work of Hall and Soskice (2001), which affect the comparative institutional analyses in general. There are two possible forms of theory building: a model can be created either empirically through the analysis of large-scale datasets or via thought experimental modelling, which is formulated in mathematical language. According to Mjøset and Clausen, Hall and Soskice are torn between the two methods. The fact that they apply the terminology of the game theory, with which microeconomics is related to macroeconomics, implies that the model was created by the second method. Nevertheless, abstract models should not directly connect with empirical cases. In contrast, in the case of Hall and Soskice, the models for the liberal and the coordinated market economies are the USA and Germany, which have been founded empirically and serve as master cases. Nevertheless, as indicated above, other empirical

cases do not confirm this dual classification. However, the small number of cases—as Hall (1999), as well as Hall and Gingerich (2004) have pointed out—do not make possible empirical testing that meets statistical requirements. It seems that Hall does not particularly force model creation built on thought experiments because, in his opinion, "The very emphasis of these models on interaction effects has made it difficult to isolate the impact of each independent variable given the limited development of equation systems modelling their full effects and the small sample (of OECD nations) against which they can usually be tested … As a result there is still an implicit emphasis in this literature on a few ideal-typical countries …" (Hall 1999: 145). However, Crouch (2005) rightly protests and claims that an ideal type should be developed by emphasising logically well-founded characteristics, and in individual cases, these characteristics may be present only partially. Therefore, the ideal type cannot be identified with one single case.

In connection with Hall and Soskice (2001), Mjøset and Clausen (2007) raise another problem, which causes difficulties in the comparative analyses. Namely, there are no established criteria for dividing an economy into institutional areas. Neither the number of institutional domains is fixed, nor are the most important institutional mechanisms determined. In comparative studies, the investigated institutional areas are similar, but there are differences in this and in the analysed institutional mechanisms, which are not theoretically founded, and their selection in itself leads to different typologies.

There is a strengthening view that as a result of critiques, the VoC approach has eroded in recent years, while this perspective is still inspiring. However, in comparative capitalism research, a new, "post-VoC" stage has evolved (Ebenau et al. 2015).

2.5 The Diversity of Market Economies

Many authors were not satisfied with the fine-tuning of the dual classification and opted for more than two models. These authors largely neglected (and only made references to) or did not deal at all with models other than those of Europe and the USA. Thus, first, we focus on two

works—the books by Coates (2000) and Amable (2003)—which have a definitely more global approach.[3]

David Coates published a study in 1999 and an entire book in 2000 on the models of capitalism. He reviewed all the attempts at typology made in the 1990s as found in the literature, and many of these attempts have been forgotten since. In his opinion, dual classification is an unacceptable simplification, and he opts for three ideal types: market-led capitalism (the USA, Great Britain after 1979), negotiated/consensual capitalism (Germany, Sweden), and state-led capitalism (Japan, Far East).

Coates (2000) presents these models and their historical evolution in his book, while making reference to the decades after WWII. In the course of this overview, it can be seen clearly that these models had different performance in terms of their competitiveness over different periods of time. His reasoning aims mainly to prove that strengthening competitiveness does not necessarily require forcing back trade unions, corporatist structures and wages, which was the central element of neoliberal thinking in the 1980s.

Amable (2003) uses the framework of new institutional economics, but at the same time he attempts to synthesise the remarks made over the course of the debates in the 1990s. He accepts North's institution definition as a starting point; furthermore, he sees institutions not only as constraints but also as an opportunity for coordination, cooperation, and information sharing. With reference to Aoki, he says that the application of the game theory does not presume perfect rationality or perfect information. He bridges the theoretical dilemma of the relationship between the individual and the institution by describing the behaviour of the actors with a two-tier game structure. The lower tier defines the agents' strategy in a given institutional framework. The upper tier is the level of the metagame, where the framework of the lower tier evolves as the result of self-sustaining equilibrium strategies. Amable himself acknowledges that this two-tier game theory needs further elaboration. He claims that the role of institutions is to settle conflicts of interest, and he describes institutional complementarity with the help of the game theory. At the same time, in his view, institutions are not merely the result of equilibrium deriving from games that can originate from individuals' pursuit of self-interest, but rather, actors gather into social groups, their conflict

of interest crosses over to the political sphere, and institutions embody a political-economic balance.

In examining the current variations of capitalism, Amable's method is different from that based on ideal types. In one of his earlier papers, he termed the various types of capitalism "the social system of innovation and production". He does not provide the theoretical background or the reason why he chose to investigate the particular institutional areas he actually analysed, but it is clear that he follows the "*régulation*" school. The institutional areas under scrutiny are the following: the product market, the labour market, the financial sector, the social protection system, and the education system. Based on the literature, Amable presumes that there are different complementarities between institutions and that there are five types of capitalism: market-based economies, social-democratic economies, continental European capitalism, Mediterranean capitalism, and Asian capitalism. Then, he examines the individual institutional areas in twenty-one OECD countries by using an empirical analysis (principal components analysis and cluster analysis). The indicators take account of the average data for the 1990s or data for the end of the decade. The OECD has already constructed composite indicators that are able to characterise a given institutional area (for example, product markets and the labour market), but others have also elaborated similar indicators for other areas. Amable accomplishes an empirical analysis by using these indicators, first for the individual subsystems; then, he performs an aggregate analysis that confirms the existence of these models.

One group is clearly distinct and homogenous: the Anglo-Saxon countries, Australia, Canada, the UK, and the USA, which represent the liberal, market-based version of capitalism. Deregulated product markets are combined with the deregulated labour market and the market-based financial system, and the education system is also organised in a competitive manner. The welfare state may have a different size according to the country concerned, with the USA and Canada on one side and the UK and Australia on the other.

The Mediterranean countries, Greece, Italy, Portugal, and Spain, constitute another group with a rigid labour market, regulated product markets, non-developed financial markets, a bank-based financial system, a low level of social protection, and a weak education system.

Using the OECD countries as a sample, only two countries—Japan and South Korea—represent the Asian economies with "governed" production-market competition, a bank-based financial system, a low level of social public expenditures, and private higher education.

Denmark, Finland, and Sweden constitute the social-democratic group. Their product markets and labour markets are regulated, their financial systems are bank-based, social protection is based on the universalist model, and their education systems are publicly funded.

The group of the continental countries is large and the most heterogeneous group, containing Switzerland, the Netherlands, Ireland, Belgium, Norway, Germany, France, and Austria. Their product markets range from competitive to mildly regulated, their labour markets are coordinated, their financial systems are based on financial institutions (banks and insurance companies), social protection is corporatist, and their education system is publicly funded. Switzerland and the Netherlands are closer to the liberal group, while others are between the Mediterranean and the social-democratic clusters.

Although Amable speaks about the social system of innovation and production, he does not include innovation in the five subsystems but rather separately analyses the patterns of scientific, technological, and industrial specialisation (that is, sectoral structure). He does not build a comprehensive indicator system, as he did in case of the previous five subsystems, and the outcome is rather fragmented. Then, he tries to find relationships between the various institutional features and economic performance by applying regression analysis. The results can be summed up by saying that there are at least two ways of reaching high-level innovation. One is a liberal way, by deregulating the product markets combined with a flexible labour market. The other way is the regulated product markets combined with a centralised financial system, which ensures long-term financing and complies with the social-democratic and partly with the continental European models. Coordinated and uncoordinated labour relations both may lead to a large growth in productivity, but only if coupled with the appropriate groups of institutions. The same can be said about the relationship between a high degree of employment and a flexible and regulated labour market. These conclusions and reasoning leading to these conclusions are rather limited to Europe; therefore, the Asian model is neglected.

Although Amable's book has received little substantive criticism, it has been frequently referenced. According to Crouch (2005: 38), "By far the best and most sophisticated approach to a 'post-dualist' typology of capitalism to date is that established by Amable (2003)", as Amable managed to avoid those instances of methodological unilateralism detailed in Chap. 1. He made his methodological individualism and his starting point—game theory—more elaborate, including bounded rationality, social conflicts, and the political-economic interpretation of equilibrium. At the same time, he has conducted more meticulous empirical analyses than his predecessors.

Amable's analysis may have one deficiency only: according to the author, the first and foremost aim of the typology is to compare the economic performance of the various models of capitalism; namely, the author does not examine how the individual social-economic subsystems contribute to economic performance, which justifies their inclusion in the analysis. He handles this topic as sociological evidence that these subsystems serve as the basis for distinguishing between the various types of capitalism. Nevertheless, innovation—critical from the point of view of growth—could have been regarded as a subsystem, and it could have been built in the models of capitalism, for instance.

2.6 Varieties of Capitalism in the European Union

2.6.1 The Models of the Old Member States

Undoubtedly, the book written by Esping-Andersen (1990) has had an impact on classifying the market economies of the EU. The book covered welfare state regimes only, not all economic systems. According to his definition, he uses a political-economic framework with an institutional approach. The result of his research is well known—the differentiation between the three welfare state regimes—therefore, this is only a reminder: the liberal system covers the Anglo-Saxon countries, the corporatist system includes mainly continental European countries (Austria, France, Germany, and Italy) and the Scandinavian, Nordic countries con-

stitute the social-democratic system. This is the first analysis (compared to all analyses discussed above) in which the Nordic countries appear as an individual group.

Boyer (1997) investigates the specific features and the future prospect of the French development path, that is, how France is positioned among the types of capitalism. In his classification, he considers the features of the labour market especially important. Market-oriented economies are the Anglo-Saxon countries (USA, Canada, and Great Britain), and with Albert's generosity, he includes Japan along with Germany among the Rhine or corporatist economies. In the social-democratic model, he presents not only Sweden but also Austria. France and Italy embody the type of statist capitalism. Boyer does not build his models on statistical analysis—as in his above-cited paper he wrote with Hollingsworth (1997a)—but he develops further and complements the known types of Anglo-Saxon and Rhine capitalism by using case studies and qualitative investigation.

Schmidt (2002) was inspired by the French institutional arrangement in her introduction of the term "state capitalism" (France, Italy) as a third ideal type in addition to market capitalism (the USA and Great Britain) and managed capitalism (Germany, the Netherlands, and Sweden). In this definition, she follows the triple typology of Katzenstein and Zysman and that of Coates. For the future, she prognosticates that institutional differences will not cease in spite of globalisation or Europeanisation.

The papers cited so far are all concerned with the question of whether competition drives developed European economies towards the Anglo-Saxon liberal model. Ebbinghaus (1999) adds a new dimension in his discussion of the issue of the European social model. The European social model has always been frequently referenced in the documents of the EU as the model that distinguishes Europe from North America or Asia-Pacific. Ebbinghaus (1999) puts the question of whether the European social model exists, and if the answer is in the affirmative, of whether it can survive. He illustrates with the help of indicators that we can make a distinction between the Anglo-Saxon, the Nordic, the European Central, the Southern European countries, and Japan. He finds that there are fundamental differences between the USA, Europe, and Japan in terms of economic performance, labour relations, the labour market, and the

welfare state. In spite of the pressure of globalisation, various institutional solutions have survived, and differences remained not only between these geographical locations but also within Europe. He finds Albert's (1993) dual categorisation, which places Europe under the umbrella of Rhine capitalism, expressly unsatisfactory. In more detailed model-making, Ebbinghaus deals with European countries only. He extends the term "social model" to "socio-economic model", which includes economic governance, industrial relations, employment regimes, and the welfare state,[4] and he distinguishes the Anglo-Saxon, the Nordic, the European Central, and the Southern European models. Although the empirical foundation in Ebbinghaus' (1999) work is narrow and casual (it functions as an illustration of his literature-based conception), its impact is important—authors rejecting the dual typology frequently cite him among their sources.

The European social model has become accepted in research on Europe, as well as in EU documents. At the beginning of the 2000s, in the research workshops working for—among others—the European Commission, increasing attention was devoted to the various development paths that became visible within the Community. According to Boeri (2002), it is customary to divide Europe into four social policy models. In his paper "Globalisation and the Reform of European Social Model", Sapir (2006) makes reference to Boeri when performing an empirically founded comparison of the performance of the four different European social models (the Anglo-Saxon, the Nordic, the continental, and the Mediterranean). Sapir's starting point is that, due to the single market and the monetary union within Europe, differences appear in social policy and in the regulation of the labour market because there is enough room for manoeuvring at a national level. Similar to Ebbinghaus, Sapir regards the welfare state and the labour market as the main sources of differences; in contrast, however, Sapir examines only the social model, not the socio-economic model. His conclusion is that among the four models, the Anglo-Saxon model and the Nordic model are efficient and the latter combines this efficiency with a high degree of equality. The continental model and the Mediterranean model are in need of reform due to their efficiency problems.

Attention must be devoted to Sapir's paper because, on the one hand, it is referenced very frequently in the literature and, on the other hand, before it was published in a journal, it was a background document for presentation at an informal meeting of the Economic and Financial Affairs Council in September 2005. This informal meeting was followed by another one in October (where heads of state and government met, but not within the framework of the European Council), and the Commission published communication for this meeting under the title, "European values in the globalised world" (CEC 2005). This paper reflects the views and thoughts mentioned above in connection with Ebbinghaus and Sapir. This report declares that there are common values that—on the one hand—serve as a foundation for a unique European approach to economic and social policies; on the other hand, these note the differences as well. Therefore, the authors of this report say that one cannot determine a single European model; however, they attempt to describe those specific features that constitute the characteristics of the European models.[5]

Given an overview of the most important sources in the literature, it is clear that by the beginning of the 2000s, in spite of the various content-based and methodological approaches, it has been largely accepted in the non-dual typologies that the old EU member states are classified into four models (Table 2.1). It is conspicuous that not a single source deals with the NMS even though 10–15 years have passed since the change in the political systems. Asian countries, expressly Japan, have been mentioned by certain authors, but no detailed model has been constructed. Naturally, the typologies represented in Table 2.1 do not cover all sources in the literature. There are always newer and newer papers and studies, but these usually fine-tune existing trends and develop them further (for example, Schröder's book (2013) combines the VoC typology with Esping-Andersen's welfare regime classification, ultimately reaching a triple categorisation).

Table 2.1 The most important typologies in the market economy models as of the 1990s

	Anglo-Saxon	Continental	Nordic	Mediterranean	Asian
Esping-Andersen (1990)	Liberal	Corporatist	Social-democratic	Corporatist	
Boyer (1997, 2005a)	Market-oriented	Rhine or corporatist	Social-democratic	State-driven	Meso-corporatist (2005)
Kitschelt et al. (1999a)	Uncoordinated liberal market capitalism	Sector-coordinated market economy (Rhine capitalism)	National coordinated market economy (labour corporatist)		Group-coordinated Pacific-basin market economy
Ebbinghaus (1999)	Anglo-Saxon	Centre	Nordic	Southern	Japan
Coates (1999, 2000)	Market-led	Negotiated/consensual	Negotiated/consensual		State-led
Schmidt (2002)	Market capitalism	Managed capitalism		State capitalism (France and Italy)	
Amable (2003)	Market-based	Continental European	Social-democratic	Mediterranean	Asian
Sapir (2006)	Anglo-Saxon	Continental	Nordic	Mediterranean	
Hancké et al. (2007a)	Liberal market economy	Coordinated market economy		Compensating state Etatist (France pre-1990s)	

Source: Author's construction

Notes: When naming the columns, geographical positions are referenced; otherwise, the different dimensions are mixed (for example, market-based and social-democratic dimensions)

The typology of Esping-Andersen (1990) covers only the welfare regimes, not the entire economic system

2.6.2 Classifications of the New Member States

The above authors use many indicators in their empirical analyses taken mainly from the OECD database or from other studies (but most of these studies obtained their data from the OECD database as well). Presumably, this is the reason why these publications do notdiscuss the Eastern and Central European countries; there are studies that present these countries separately from the developed countries and compare them to each other (for example, Hancké et al. 2007b; Lane and Myant 2007; Estrin et al. 2007). As part of a research project led by Amable and completed in 2008, Berrou and Carrincazeaux (2005) integrate the Czech Republic, Hungary, and Poland (that is, those Eastern and Central European countries for which the data are accessible in the OECD database) into their classification.

In the last two decades, several attempts have been made to compare the Eastern and Central European countries with the existing models, but these cover only few countries, or the scope of the applied data and viewpoint is not as wide as in the case of the old capitalist countries.

Berrou and Carrincazeaux (2005), after performing a cluster analysis, conclude that the Czech Republic, Poland, and Hungary are similar to the Mediterranean countries.

Cernat (2006), using very few indicators, conclude that Estonia belongs to the Anglo-Saxon group, while Bulgaria, Poland, Latvia, Lithuania, Romania, and Slovakia to the continental category. Surprisingly, Cernat places the Czech Republic, Hungary, and Slovenia in the category of developmental capitalism, which is characteristic of the Asian countries. He gives a detailed study of his own country, Romania. In this case study of Romania, he says that compared to the other countries, Romania only partly fits the continental model, so he uses the term "cocktail capitalism" for the country. In the course of capitalist transformation,globalisation (and the World Bank) transferred the Anglo-Saxon model, while the European Union transferred the Anglo-Saxon and the continental models, and the domestic circumstances moved the country towards the direction of state-centred, clientist capitalism. As a result of these impacts, the outcome has become inconsistent and inefficient.

Lane (2007) gives a review of the model creation of the market economies, dealing with the books by Hall and Soskice (2001) and Amable (2003) in more detail. Nevertheless, this is not the basis on which he classifies the countries that underwent capitalist transformation. His starting point is that the Western advisors suggested the application of the Anglo-Saxon model with full liberalisation, free trade, and privatisation as the key elements. Therefore, he compares the extent of privatisation and stock market capitalisation, the size of the private sector's share of domestic credit as a percentage of GDP, the size of FDI as a percentage of GDP, and the transnationality index (elaborated by the UN expressing the ratio of FDI in output, exports, and employment) in the post-socialist countries. In the case of all indices, there are fundamental differences between the CEE countries (including the Baltic countries) and the former Soviet member states. Only stock market capitalisation and the share of domestic credit exhibit low levels everywhere. Lane compares the CEE countries to the continental countries, and he creates a subgroup in which privatisation is less extensive and state intervention remains more intensive (Bulgaria, Croatia, Latvia, Lithuania, and Romania). The other, economically poorer group, in which the transition was unsuccessful, contains the following countries: Russia, Ukraine, Kazakhstan, Georgia, Turkmenistan, and Moldova. The situation in these countries has become chaotic; to describe it, the author uses the term "hybrid state/market uncoordinated capitalism".

In the same volume, Knell and Srholec (2007) use Hall and Soskice's dual classification and Hall and Gingerich's empirical analysis method as a starting point. Built on data from 2001 to 2004 and using 13 indicators, they construct the indices for social cohesion, labour market regulation, and business regulation and explore in detail certain aspects of labour relations. They examine the Eastern and Central European post-socialist countries, including the Western Balkans, the Soviet successor states, Vietnam, and China, together with the developed OECD member states. Regarding social cohesion (the size of the public sector and income inequalities), the majority of the post-socialist countries are more similar to liberal coordination than the USA; at the same time, business regulation more closely resembles coordinated market economy. On the other hand, if labour market regulation is taken into consideration, these

countries are entirely divided between the models of the liberal and the coordinated market economies. This study may serve as a warning example of the uncontrolled application of statistical data because, according to the cumulative index, Armenia, Georgia, Moldova, and Mongolia are at a level of market coordination similar to that of, for instance, Hungary, Estonia, Slovakia, or Lithuania, which is an obviously absurd result.

King (2007) applies the VoC framework for the transition countries. He describes their development path with the help of six characteristic features: average per capita GDP growth between 1991 and 2000, change in male life expectancy between 1989 and 2000, percentage of the population below poverty, net FDI inflow, an EBRD Governance Indicator, and the security of property rights index. He contrasts the liberal dependent states (the Czech Republic, Poland, and Hungary) with the patrimonial states (Russia, Romania, Ukraine, and Milosevic's Serbia). His description of the latter group is very similar to Lane's (2007) definition of uncoordinated capitalism. King (2007) adds that the liberal dependent states show elements of proto-coordination and proto-liberalism. The explanation for this lies in the fact that there are two essential differences that separate them from the Western European countries, namely, that their dependence on foreign capital, foreign technology, and foreign customers is huge and that workers are defenceless.

Bohle and Greskovits (2007) argue that after the fall of the socialist system, three versions of capitalism emerged in Central-Eastern Europe: a purely neoliberal type in the Baltic states, an "embedded" neoliberal type in the Visegrád countries, and a neo-corporatist system in Slovenia. When creating these types, the authors address new aspects, not those described so far. In addition to the usually examined fields of the welfare state and labour relations, industrial structural change, macroeconomic stability, and even the dynamism of the political systems were subject to scrutiny. The other novelty of these authors is also—compared to the studies above—that they take the specific features of the socialist legacies into account and, starting from here, they present the evolution of the models from a historical perspective. In addition, they integrate the impacts of the EU and the transnational companies in their explanation. Their paper in 2007 was followed by a book (Bohle and Greskovits 2012), which I return to later.

Mykhnenko (2007) compares Ukraine and Poland, and despite their differences, he regards these countries as the weakened versions of the continental model or—by using the terminology of Hall and Gingerich (2004)—as mixed market economies (which complies with the Mediterranean model).

Estonia and Slovenia led Feldmann (2007) and Buchen (2007) to present the CEE manifestation of the liberal and coordinated market economy.

Blanke and Hoffmann (2008) assume that the Baltic countries follow the liberal model, while the Czech Republic, Poland, Hungary, and Slovenia follow the model of a coordinated market economy.

Similarly, Csaba (2009b) emphasises the differences between the transformed countries. On the basis of the degree of state redistribution, three Visegrád countries, the Czech Republic, Poland, and Hungary, can be differentiated from Slovakia and the Baltic countries (their level is similar to the Anglo-Saxon one). Romania and Bulgaria are not included in the latter group because in these two countries, the contribution of agriculture to GDP and to employment exceeds by far the level of the other CEE EU member states. Furthermore, the Commonwealth of Independent States (CIS) is sharply different from the NMS of the EU; in the former states, the state-led economic model seems to have settled.

Schweickert et al. (2013) make a distinction between liberal and coordinated market economies within the CEE EU member states by applying the dual classification of VoC.

The CEE countries are regarded by the report prepared by the European Commission on Industrial Relations in Europe (European Commission 2009c) as a distinct model of capitalism, which is presented in Table 3.6. At the same time, the report leaves some institutional areas open, which will be the final solution from among the controversial tendencies. Rodrigues (2009) explores the variations of capitalism within the EU in connection with the Lisbon strategy, and she notes that the Eastern type should be elaborated as well. In the same volume, Török (2009) confirms with the help of a few other aspects that the CEE countries constitute a distinct model. Schweiger (2014) classifies that the CEE countries have a "transition model" with some common challenges but with noticeably differences in their culture and the development of their economies and

welfare states. However, he considers that it is justified to speak of an emerging new variety of capitalism in this region.

Nölke and Vliegenhart (2009) prepare a thorough inventory of the attempts made so far in the framework of VoC to classify the market economies that have emerged in the transition countries. They note the discrepancy in these attempts because some studies have argued that the East Central European countries converge towards the liberal model, while others claim that convergence towards the coordinated market economy occurred. A third group regards these countries as the hybrid variation of the two models. Nölke and Vliegenhart (2009) argue that the contradictory results can be attributed to the premature, mechanistic application of quantitative approaches. In their study, they prove the existence of a new capitalism model, which they termed a "dependent market economy", but their investigation covers the Visegrád countries only. The comparative advantage of the dependent market economies is due to the institutional complementarity characterised by skilled but cheap labour, technological innovations received through transnational companies and capital provided by FDI. The authors derive all features of the dependent market economy model from the essential role of foreign capital, which has a huge impact on the system of corporate governance, industrial relations, education, and training, as well as the innovation system. As a result, it is easy to show complementarity between the elements of the model that have been derived from a single factor. A merit of the study is that in several definite areas (for example, industrial relations and corporate governance), it demonstrates that very different institutional correlations may exist behind the quantitatively very similar data. This illustrates rather well the methodological challenge needed to interpret the statistical analyses together with case studies. It is also without doubt that the role of FDI has its special features compared to the developed, old market economies, and it has an explanatory power concerning the evolution and operation of the institutional system. However, in their study, the authors apply FDI unilaterally as a single, universal explanatory factor. For instance, in comparison with the study by Bohle and Greskovits (2007), it is striking how important elements are left out from the attempt to understand the institutional systems of the countries concerned.

From the above overview, it can be clearly seen that no common standpoint has evolved in the literature regarding the assessment of the institutional system of the transformed post-socialist countries. On the contrary, opinions are divided and expressly opposing. Agreement has been reached in only one question—which is outside the scope of this study—namely, that the difference is huge and qualitative between the post-socialist EU member states and the CIS.

2.7 Theoretical and Methodological Considerations

In Sect. 1.7, the methodological starting position that will be followed in the course of my institutional analysis is defined. In Chap. 2, the comparative economic analyses were covered, and the development of the classifications concerning market economies was explored. Let me summarise the main points of Chap. 2 by following the principle defined in Sect. 1.7.

In spite of the fact that in the literature, the dual classification of Hall and Soskice is considered the starting point in most cases, in my opinion, Amable's empirically based model construction is more convincing, that is, it describes the models of market economies with the help of various social-economic subsystems. Because his results concerning Europe have been confirmed by other authors, I will use this model as a reference point, and the CEE countries will be placed into this framework.

At the same time, we must be aware of the fact that the application of quantitative methods has its limitations. The most important of these limitations is that it is impossible to satisfactorily explore the causal relationships and the effect mechanisms in the background of the phenomena by statistical means (regardless of whether it is a cluster analysis or regression analysis).[6] The investigations are naturally influenced by the scope of the available statistical data. Furthermore, when countries are compared, the number of the elements is so small that it weakens the statistical power. However, as the number of countries with different features and with different degrees of development involved in the investigation increases,

the possibility that the conclusions will be superficial or biased increases. Given an overview of literature, it seems that the researchers agree that the quantitative investigations must be complemented with qualitative analyses in order to overcome this difficulty or to at least mitigate the related problems, for example, with the help of historically oriented case studies (Shalev 2007; Pontusson 2007; Esping-Andersen 2007).

In order to provide a well-established foundation for the results of this research, the quantitative and qualitative methods are applied together. In addition, in the course of this investigation, I have kept track of and will apply the results of neoclassical research. On the one hand, in this work, the subsystems involved in the investigation in order to construct the market economy models are not considered evidential, but it will be examined whether macroeconomics justifies their significance from the viewpoint of the given economic system's performance. On the other hand, the neoclassically founded analyses are also useful, as the operation of the market economies during the crisis will be presented below.

The current crisis gives us an opportunity to perform an unusual methodological experiment: we are able to observe the operation of an institutional system modelled at the threshold of the crisis within the circumstances of a global crisis. This means that the mainstream economic analyses must inevitably be applied alongside the institutional comparison and that institutional changes, that is, the methodologically critical element of the comparative studies, must be presented as well.

In spite of methodological open-mindedness, I am aware that it is impossible to eliminate all uncertainties from the conclusions I may draw and that future investigations may impel me to review the results.

Notes

1. In his entry in *The Elgar Companion to Institutional and Evolutionary Economics*, Jessop (1994) says that the French "*régulation*" school and its three branches have their roots in Marxism. According to Jessop, the representatives of this school consider the institutions of capitalism the results of historical development in which the relatively stable capitalist expansion—

which took place during a long historical period—was due to non-economic, institutional factors. Furthermore, they emphasise the transformation potential of social actions. Boyer indicates the Parisian branch's Marxist roots from the 1970s (Boyer 2005a); however, in Boyer's analyses written in the 1990s or later, all statements would easily be part of a standard sociological analysis.

2. According to a footnote in the book, GDP data were calculated at the exchange rate and price level in 1975.
3. Becker (2009) rejects dual classification, regarding capitalism as an open social system, and he introduces an empirically founded typology in his book, which involves Japan; however, this book is less elaborate than Amable's book (2003). Therefore, I do not discuss it in detail.
4. Not only Ebbinghaus can be characterised by dual interpretation. In the literature, the term "European social model" sometimes refers to the system of social protection only, but in the case of others, it is used in a broader sense, referring to an economic-social model, which also appears in the name itself in the case of certain authors. O'Hagan (2002) follows the content-wise changes in the concept of the "European social model" from the Paris Summit held in 1972 to the beginning of 2000s.
5. Common features of the European model include the following:

   - Common values of economic and social policies: solidarity and cohesion, equal opportunities and the fight against all forms of discrimination, adequate health and safety in the workplace, universal access to education and healthcare, quality of life and quality of work, sustainable development and the involvement of civil society. These values represent a choice in favour of a social market economy.
   - In the member states of the EU, the public sector plays a bigger role than in Asia or in the USA, and public spending on social protection is higher than in the USA or in Japan.
   - Compared to other regions in the world, national systems are reinforced by European-level policies.
   - There is a strong tradition of social dialogue and partnership (CEC 2005).

6. The well-known methodological problems (endogeneity, multicollinearity, and so on) are beyond the scope of this study.

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Part II

Models of the Market Economy in the EU at the Threshold of the Global Financial and Economic Crisis of 2008

3

An Empirical Analysis of the Economic System

Based on the theoretical grounding in Part I, I accept the method of empirical model construction. As we have seen, in generating models for the market economies of the EU as they pertain to the older member states, a relative consensus exists in the literature in terms of distinguishing among the four accepted models; namely, the Nordic, continental, Anglo-Saxon, and Mediterranean models. For this reason, it might be reasonable to conduct an empirical institutional analysis exclusively of the NMS. However, two factors prompt opting for a full investigation once again. On the one hand, data from Amable—who carried out the most thorough empirical investigation so far—date from the 1990s; therefore, it is interesting to repeat the process with data from a decade later. On the other hand, the same set of indicators could not be generated because some of the NMS are not featured in the Organisation for Economic Co-operation and Development (OECD) database used by Amable.

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In the case of the post-communist member states, after reviewing the literature on the subject and the contradictory results produced therein, it is reasonable to ask how the new, former communist member states of the EU fit into models elaborated for the OMS when attempting to provide an answer based on a comprehensive, empirical investigation. Two decades after the change in the political system, we can assume that a stable framework of economic and social order is in place, which lends itself to analysis. We might put it another way by asking whether these member states approach any existing model or whether, based on their common distinctive features, they represent a new model of their own or even contain several models among themselves.

One important criticism levelled at comparative investigations and the modelling of market economies is that the selection of the examined institutional elements leaves too much to chance. If an institutional comparison is carried out from the point of view of suitability for economic growth—as in the present case—theoretically, limits to the sphere of relevant institutions are set. Mainstream growth theories can help us because they also allude to institutional components of growth. The endogenous growth theory of Barro and Sala-i-Martin (2004) takes into account data pertaining to the education system, healthcare provision, the quality of public administration, government expenditures, and political democracy among institutional type variables explaining growth, with innovation seen as the central growth factor. According to Barro (1997), the long-term growth rate also depends on government functions such as taxation, maintenance of the rule of law and public order, provision of infrastructural services, protection of intellectual property, and the regulation of international trade, financial markets, and other areas of the economy. At the same time, these investigations do not define why these—and only these—institutional variables are included in regression analyses in this way. In other words, regardless of whether Amable's sociologically rooted approach or the mainstream economic growth theory is taken into account, the uncertainty cannot be eliminated in the selection of institutions in market economic modelling. Nevertheless, some reinforcement may be gained in two aspects. On the one hand, the elements listed in endogenous growth theory allude to the subsystems featured in Amable's approach (the regulation of product markets, innovation, the financial

system, the education system, and welfare provision). That the role of human capital as a growth factor is beyond question indirectly justifies the inclusion of the labour market. On the other hand, numerous macroeconomic research studies prove the connection between individual subsystems and economic growth. That is, while the inclusion of certain subsystems can be satisfactorily justified in building the models, it cannot be guaranteed that institutions relevant from the point of view of growth performance will not be omitted. There is scarcely room for doubt that the structure of the state and the political system, combined with the customs, traditions, and norms of society, influence the functioning of a market economy. However, the incorporation of these factors into market economic models extends beyond the scope of my economically based investigation.

In selecting the range of subsystems, I therefore accept Amable's work (2003), with the difference that while he did not analyse research and development and innovation (R&D&I) as an independent subsystem, this approach is nevertheless justified from the perspective of growth theory. Prior to each individual statistical analysis, I review whether the significance of the investigation criteria applied to the performance of the economic system and economic growth by Amable—and in the comparative economics in general—can be defended within the given subsystem based on current macroeconomic research. These macroeconomic results are summarised in the introductory sections.

Among the socioeconomic sectors, I examine product markets, R&D&I, the financial system, the labour market, the system of social protection, and education. The database I have established uses data from Eurostat, the European Central Bank (ECB), the World Bank, and the Fraser Institute. Due to insufficient data, I must omit the two member states, Cyprus and Malta, and I cannot include Croatia—which became a member state from 2013—for similar reasons. I select the information to include only "hard" data, thus giving preference to measurable data over indices formed on the basis of the opinions of economic actors.

In order to render international institutional comparisons measurable, it has become widespread practice among both international organisations, such as the OECD, European Bank for Reconstruction and Development (EBRD), and authors of VoC studies, to map the existence

of institutional differences using some form of indicator. For individual subsystems, I have gathered all those indicators currently in use in the literature. However, indicators measuring input or output do not in themselves necessarily offer a precise picture of institutions, and for this reason, I always compare the results of the cluster analysis with conclusions uncovered in the literature and qualitative studies. In this way, I believe the problem whereby similar indicator values in statistical groupings do not necessarily conceal an actual institutional similarity can be avoided.

The indicators show the average of three years taken from the mid-2000s; I intend to reflect the situation that existed prior to the crisis, that is, to "take a snapshot" that filters out possible fluctuations. It is not yet possible to determine whether the changes that the current global economic crisis has brought signify lasting institutional transformations or if they are transitory changes that might lead us to draw only markedly distorted conclusions regarding the institutional framework.[1] After the crisis and once an ensuing period of stabilisation has elapsed, it will be worth repeating these measurements. Then, it will be possible to make an empirical comparison of the way individual countries have reacted to the crisis through institutional changes. Given that my primary goal is to classify countries according to their type within the individual subsystems, as well as to represent them in some form of—preferably—two-dimensional diagram, the principle methods of my examination are cluster analysis and multidimensional scaling (MDS).

In applying cluster analysis—which produced interpretable results despite the small number of elements—I tried out several possible numbers of clusters, finally taking two aspects into account in deciding on the number of clusters:

- The individual clusters should be economically interpretable. I have provided an interpretation of the clusters based on cluster centres.
- The individual clusters should be comparatively homogeneous, meaning that the standard deviation of variables that form the clusters should be lower within the clusters compared to the whole.

In multivariate analyses, point configurations can be represented within several different frames of reference. MDS served as the basis for the graphic representation of countries and clusters applied. The result of MDS can be regarded as interpretable provided that the S-stress value obtained in the given dimension is below 0.2 and that the artificial dimensions are interpretable. Ideally, the value of this indicator should be below 0.1. With the exception of product markets, this stricter condition was successfully met in all areas.

For the interpretation of artificial dimensions, the relationship between the standardised variables and the primarily received dimensions was examined, and when the dimensions could not be apprehended unequivocally, a clarification was carried out. In other words, I projected the group of variables shaping the individual dimensions on a dimension, taking the S-stress value into consideration. The indicators, their mean values, and standard deviations within the individual clusters, as well as descriptions of the cluster centres characterising the clusters, are contained in Tables A.1–A.6 of the Appendix. The exercises were run in Statistical Package for the Social Sciences (SPSS) software (version 15.0) using K-means clustering.

3.1 Product Markets

3.1.1 The Relationship Between Competition, Productivity, and Innovation

In describing individual models of capitalism, one of the most important aspects in classifying these models by type is the strength of competition on respective markets and how much the state restricts this competition. In economics, there is a generally accepted correlation among mainstream authors whereby the strengthening of competition and deregulation increases economic performance, while curbing state intervention has a beneficial effect on economic growth. On the one hand, competition boosts economic growth by encouraging innovation, which, in turn, increases productivity. On the other hand, it forces managers to

make better use of their resources by allocating them more efficiently. It is not the object of this book to analyse the macroeconomic debates that revolve around this nor to discuss what other preconditions related to economic policy or institutions, for example, are required in order for the desirable effects of free competition to be genuinely felt. I aim only to provide a short summary of the insights attained in the literature of the past decade. In most studies, questions of competition and growth go hand in hand with the discussion of research and development and innovation (R&D&I); therefore, it will become evident in the following why R&D&I are treated as an independent subsystem.

Ahn in 2002 and Sharpe and Currie in 2008 completed wide-ranging reviews of the relevant literature. Although several studies discussing the connection between competition, innovation, and increasing productivity are of a theoretical nature, for the most part, these studies do not stop at creating models, but submit them to empirical testing. The remaining studies endeavour to compare international experiences. Work carried out within the OECD framework is the most influential, as material prepared here culminates in proposals for the reform of economic policy. The third type of approach is the case study. Based on the aforementioned reviews of the literature, it can be stated that empirical evidence confirms the positive influence that intensity of competition exerts on innovation and productivity.

Høj et al. (2007), in investigating the relationship between profit margins and market regulation, find evidence that liberalisation increases the strength of competition in the OECD countries. On this basis, they make competition policy recommendations for the strengthening of competition in the service sphere. Dutz and Hayri (2000), carrying out their investigations in various regions of the world economy, find an overall close correlation between long-term growth and efficient competition policy. Data from the Far East region, however, indicate a far weaker connection, prompting the authors to caution against oversimplification. With regard to the OECD countries, Clougherty (2010) confirms the positive relationship between committed competition policy and economic growth. Blanchard and Giavazzi (2003) make similar arguments supporting the benefits of market deregulation and formulate conditions

with respect to both the product and labour markets, which they deem necessary in order for deregulation to generate growth.

One independent line of debate takes as its starting point Schumpeter's theory, which—contrary to the above—posits that competition weakens the incentive to innovate because the prospects of rent from innovation deteriorate with keen competition. The National Bureau of Economic Research has produced a series of studies that combine the Schumpeter effect with the eventuality in which competition stimulates innovation. Acemoglu et al. (2002) differentiate an investment-based growth strategy from one based on innovation. The former has been applied successfully by emerging economies, where it may allow room for state intervention, direct subsidies and restricted competition. In the case of innovation-based growth in proximity to advanced technologies, competition and the selection of successful companies and managers play an increased role. There is a danger that following successful convergence, an economy will not shift over to the innovation-based path necessary to ensure continued growth. In addition, interested groups that have gained strength during the period of investment-based growth may acquire political influence, potentially obstructing the transition to innovation-based growth. Aghion et al. (2005) portray the link between competition and innovation using an inverted U-shaped curve. In this model, innovation occurs step by step. Here, innovation is principally motivated not by the innovation rent in itself, but rather by the difference between the pre-innovation and post-innovation rents. If the initial level of competition is low and the technological standard even in most sectors, then strengthening competition will stimulate innovation because companies can thus "escape" competition. If competition is already intense and the technological standard of most sectors is uneven, there is no motivation for underdeveloped companies to innovate, as the achievable innovation rent is modest, such that the Schumpeter effect comes into play. In industries in which companies are close to the technology frontier, strong competition encourages innovation (and thus the aforementioned "escape effect" dominates). With the help of British data, the authors see their model as empirically justified. Based on data from 40 developing and transitional countries, Alder (2010) finds that here, too, companies behave differ-

ently amid competition according to their distance from the technological frontier.

In summary, both theoretically and empirically, competition increases the performance of the economy. Therefore, the customary standpoints of the VoC literature in the analysis of product markets can be accepted, namely, the power of competition and the presence of the state. At the same time, the change in the framework of ownership was of central importance in the transformation of the economic system in the post-socialist countries. This finding justifies introducing indicators relating to the ownership structure as well, which is missing from the methodology developed for mature market economies. Nevertheless, in the absence of comparable data available for all countries, it was not possible to do this. International collection of data exists only with regard to FDI, and only this have I been able to utilise.

3.1.2 Product Markets of the Member States

In the EU, integration unquestionably materialised earliest and most profoundly in the commodities market, with the regulation of competition limiting the opportunities for state intervention within narrow bounds. Competition can also force states to break down bureaucratic obstacles in the way of businesses in the interest of improving the given member state's competitiveness, leading to the creation of a level playing field in the regulations pertaining to enterprise. However, product markets and competition within them are impacted not only by state regulation but also by individual economies' openness to foreign trade (including the movement of goods and capital), which is simultaneously an important feature of an economy's structure as a whole.

For this reason, I examine the product markets of member states in two dimensions. One is the level of integration of markets in foreign trade, in which not only the ratio of foreign trade and of the stock of outward and inward FDI to GDP was measured but also the equilibrium in the balance of trade. In the other dimension, I aimed to grasp the level of market liberalisation by measuring the extent of price regulation and state investments, the scale of taxation, and the burden of bureaucratic

procedures connected to the operation of companies, the latter expressed in terms of both time and cost.

Based on the cluster analysis, the great majority of OMS (Austria, Belgium, Denmark, the UK, Finland, France, the Netherlands, Ireland, Germany, Portugal, and Sweden) were assigned to the first cluster. This cluster, in addition to few bureaucratic obstacles and little direct state presence, is characterised by higher tax levels and a moderate degree of openness to foreign trade, as well as by a stock of outward and inward FDI above the EU average. There are significant differences in the level of international integration among the countries concerned, principally due to disparities in size.

The NMS can be classified into two quite distinct groups. The second cluster, comprising Bulgaria, Poland, Romania, and Slovenia, lies further from the cluster of OMS. These economies' moderate openness to foreign trade is accompanied, in the case of Romania and Bulgaria, by a severe struggle with imbalances. Except for Bulgaria, the ratio of inward FDI to GDP is below the EU average, while outward FDI is all but negligible for all these countries. Although their tax levels are lower than in the cluster of OMS, bureaucratic obstacles are greater.

The other group (the Czech Republic, Estonia, Latvia, Lithuania, Hungary, and Slovakia) lies closer to the cluster of OMS. This group has a greater openness to foreign trade and a ratio of inward FDI to GDP that is slightly above the EU average, while outward FDI is very modest in scale, albeit greater than in the preceding cluster. Bureaucratic obstacles are greater than in the first cluster. Substantial differences exist within the group, due mainly to the severe imbalance in foreign trade in the Baltic states. The level of taxation is lower than in the cluster of OMS and, in terms of tax brackets that lend themselves to comparison, even Hungary does not show values conspicuously different from other members of the cluster (although the level of state deductions from income is higher than in other countries in the cluster). The Czech Republic borders on the second cluster in this regard, while Estonia borders on the first cluster.

The three Mediterranean countries, Greece, Italy, and Spain, make up the fourth cluster. These are comparatively closed economies, reflected in a stock of outward and inward FDI below the average, with a more

powerful state presence and greater bureaucratic obstacles. Spain borders on the third cluster.

Luxembourg, by virtue of its conspicuous openness due to its peculiar situation and size, stands apart from the OMS, forming a separate cluster (Table 3.1).

I have represented product markets in two dimensions (Fig. 3.1), with market liberalisation expressed on the horizontal axis (S-stress: 0.19) and the economy's level of international integration on the vertical axis (S-stress: 0.05). The figure clearly demonstrates what we have already seen in the cluster analysis: that unequivocal boundaries cannot be drawn

Table 3.1 Product market clusters

	Clusters	
1.	Moderately open, with balance in foreign trade Above-average stock of outward and inward FDI Little direct state presence Higher tax levels Few bureaucratic obstacles	Austria, Belgium, Denmark, UK, Finland, France, Netherlands, Ireland, Germany, Portugal, Sweden
2.	Moderately open, with significant imbalance in some countries Stock of inward FDI below average, outward FDI negligible Stronger state presence, but lower taxes Significant bureaucratic obstacles	Bulgaria, Poland, Romania, Slovenia
3.	Highly open, with significant imbalance in some countries Stock of inward FDI above average, outward FDI meagre Low-level state presence Moderate bureaucratic obstacles	Czech Republic, Estonia, Latvia, Lithuania, Hungary, Slovakia
4.	Comparatively closed economies, with foreign trade imbalances Below-average stock of outward and inward FDI Comparatively powerful state presence Significant bureaucratic obstacles	Greece, Italy, Spain
5.	Conspicuously open, strikingly large stock of outward FDI Moderate state presence Few bureaucratic obstacles	Luxembourg

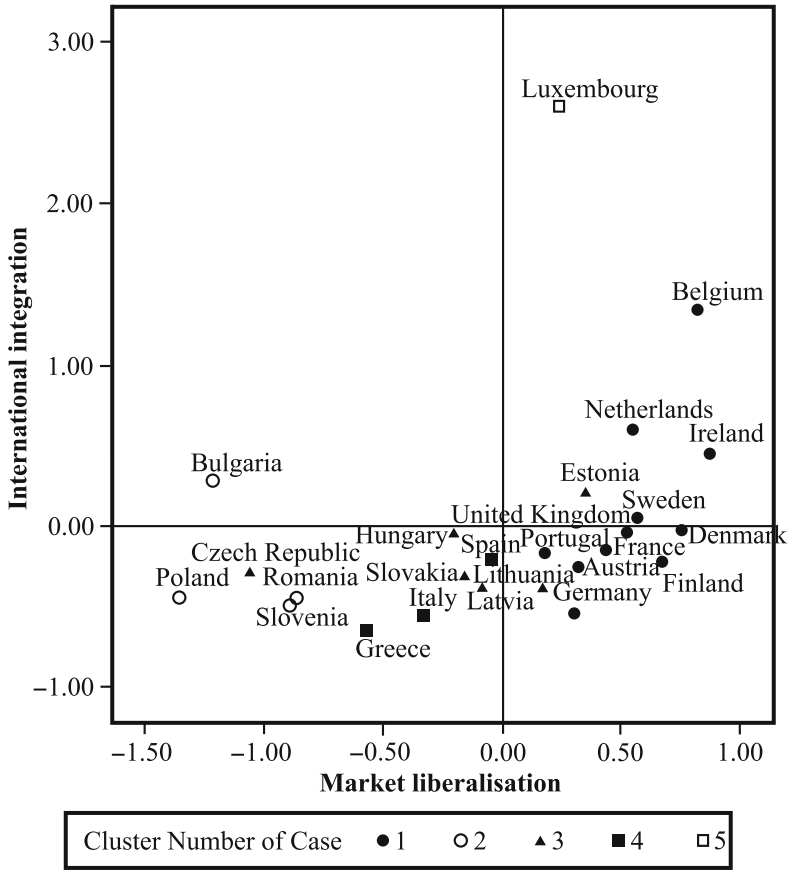

Fig. 3.1 Two-dimensional MDS-based representation of product markets

between the clusters in the way we will later be able to do for the other subsystems.

The results obtained differ somewhat from the conclusions reached by other studies with respect to the OMS. On the one hand, Amable (2003) examined product markets based on indicators formed from data generated at the OECD at the end of the 1990s (Nicoletti et al. 2000). On the other hand, the OECD's research team repeated the analysis in 2003, expanding it to include the Czech Republic, Poland, and Hungary (Conway et al. 2005). A conspicuous difference is that my study could

not reveal the unequivocal separation of the English-speaking countries (the UK and Ireland), which is so strikingly apparent in the above-mentioned analyses. There may be several reasons for this. For the sake of the available data pertaining to the NMS, it was necessary to thoroughly revise the range of indicators. State supervision and regulation could be assessed by using significantly fewer indicators due to a lack of data. At the same time, bureaucratic obstacles were characterised by using data measurable only in time and cost based on World Bank sources ("Doing Business"). In the OECD material, however, no small proportion of the indicators were created by re-coding the prescriptions of legal regulation; therefore, it is conceivable that the differences in implementing looser or more rigid regulations, in terms of their time and cost effects, are not as significant as the legal regulations might suggest.

The 2005 OECD study clearly showed that between 1998 and 2003, differences among the EU countries in the functioning of product markets significantly decreased (Conway et al. 2005). If this continued in the 2004–2006 period examined here, it might explain why the English-speaking countries do not form a separate cluster. In any case, not only did convergence occur among the member countries in the regulation of market competition between 1998 and 2003, but it is also generally typical of all EU member states that regulation stimulates competition, which is to say that the unified internal market has proven to be a successful framework. Griffith et al. (2006, 2010) reaches similar conclusions.

3.2 R&D and Innovation

3.2.1 Technological Progress and Growth

With respect to the analysis of product markets, the correlation between competition, productivity, and innovation was taken as a starting point. In addition, treating the system of innovation as a separate subsystem is justified by the clear importance assigned to technological progress in current growth theories. In the neoclassical growth models of the 1950s and 1960s, technological development featured as an exogenous factor,

and by taking this factor into account, it was possible to presuppose a positive rate of growth in the long term. The fact that the source of long-term growth was an element outside the model ultimately left long-term growth itself without an explanation. Attempts were made to remedy this deficiency with endogenous growth theory, but this brought its own set of problems. The fruits of technological progress are embodied partly in elements of the economy, which are non-competitive and possess certain properties of public goods. If the non-rivalrous new ideas are included among factors of production, increasing returns to scale may arise, incompatible with perfect competition. R&D theories and the concept of imperfect competition were incorporated into growth theory beginning at the end of the 1980s. In these models, technological advancement is the result of conscious research and development, the reward for which—to follow Schumpeter—is some form of ex-post monopoly. Barro (1997) presents the evolution of growth theory, a now classic, detailed exposition of which is provided by Barro and Sala-i-Martin (2004). Subsequent research has also demonstrated, based on a sample containing 71 developed and emerging countries, that innovation-driven growth is advantageous not only because it increases productivity but also because it creates more jobs; moreover, innovative companies employ proportionately more unskilled labour, so that their growth is inclusive from a social point of view (Dutz et al. 2011). Inasmuch as proponents of growth theories agree on the determining role of technological development, this theme requires no further discussion here.

3.2.2 R&D&I in the Member Countries

In analysing R&D&I, not only expenditures and available human resources have been taken into account but also employment in high-technological industries and knowledge-intensive services, exports of high-technological products and licensed patents. In this way, we can measure the strength of presence of advanced technologies in the economy alongside R&D activity. In cluster analysis, the Nordic and continental countries are markedly separate from the Mediterranean and post-socialist countries.

The vanguard countries are unquestionably Finland, Sweden, and Germany. Here, the business sector accounts for two-thirds of high-level R&D expenditures. Particularly in Germany, these expenditures are paired with a high level of employment in advanced technological industries. Sweden and Finland tend to excel more in knowledge-intensive services. These countries also figure prominently in terms of patents per number of inhabitants compared to the other clusters.

Due to its unique circumstances, Luxembourg again carves itself a separate position. Corporate financing plays a strikingly large role in moderate R&D expenditures. The proportion of exports of advanced technological products is high and that of knowledge-intensive services also above average.

A moderate level of R&D expenditures characterises the cluster comprising the other continental countries, Ireland and the UK, in which the share of the business sector exceeds 50 per cent, but is still lower than the aforementioned groups. In keeping with this, there are significantly fewer patents per number of inhabitants than in the vanguard countries. The proportion of exports of advanced technological products is high, as is the proportion of those working in knowledge-intensive services.

The cluster comprising post-socialist and Mediterranean countries is characterised by a low level of R&D expenditures. The government share of financing reaches 50 per cent, while that of the business sector is accordingly low. The ratio of patents to the population is dramatically lower, even lower than the preceding cluster. The presence of multinational firms may explain the smaller-than-expected gap in employment and exports compared to the other three clusters (Table 3.2).

The horizontal axis in Fig. 3.2 shows the degree of development of countries' R&D systems, while the vertical axis indicates the weight of high-technological products in exports, as well as the proportion of those employed in knowledge-intensive fields (S-stress: 0.02)

Several attempts have been made in the literature to draw up an empirically grounded ranking or grouping of EU or OECD countries.

Hall and Soskice (2001) argued that of the two basic types of modern capitalism, the liberal market economy promotes radical innovation, while the coordinated market economy encourages incremental innovation. From the observation of the innovative activities of the world's

Table 3.2 R&D&I clusters

	Clusters	
1.	High R&D expenditures, high contribution by the business sector High level of employment in advanced technologies High ratio of patents to the population	Finland, Germany, Sweden
2.	Moderate R&D expenditures, high contribution by the business sector High level of exports of advanced technological products High ratio of US-registered patents to the population	Luxembourg
3.	Moderate R&D expenditures, moderate contribution by the business sector High level of employment and exports in advanced technologies Moderate ratio of patents to the population	Austria, Belgium, Denmark, UK, France, Netherlands, Ireland
4.	Low R&D expenditures, low contribution by the business sector Below-average exports and employment in advanced technologies Low ratio of patents to population	Bulgaria, Czech Republic, Estonia, Greece, Poland, Latvia, Lithuania, Hungary, Italy, Portugal, Romania, Slovakia, Slovenia, Spain

developed economies, Taylor (2004) concluded that the aforementioned division is unsustainable. According to Akkermans et al. (2009), Hall and Soskice's conclusion, though invalid as a principal rule, still applies to many branches of industry.

A comprehensive picture is provided by the European Innovation Scoreboard (EIS), issued annually within the framework of the Lisbon Strategy. The EIS report for 2008 employed a total of 29 indicators, including those applied in my study. An index made up of these indicators produced a ranking of the member states. Taking a five-year period as its basis, the report also created clusters based on the indicators used. Sweden, Finland, and Germany are joined as innovation leaders by Denmark and the UK. The group of innovation followers coincides with our third cluster (naturally without the promoted Danes and Brits). The Mediterranean and NMS are split among the groups of moderate innovators and catching-up countries (Table 3.3) in somewhat different positions than those suggested in the MDS diagram (Fig. 3.2). It is worth

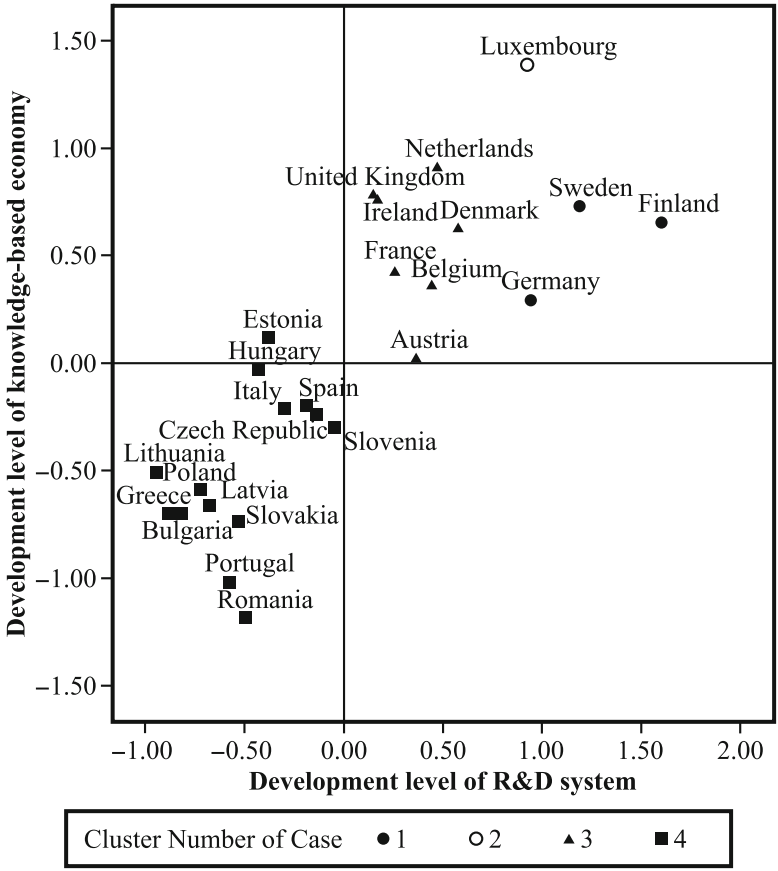

Fig. 3.2 Two-dimensional MDS-based representation of R&D&I

noting that Estonia precedes even Slovenia in the EIS ranking of innovative performance (UNU-MERIT 2009).

In the cluster analysis, I document a given situation, while the EIS report also measures growth in the examined five-year period based on changes in indicators in several other European countries, as well as in the EU-28 member states.

Due to the time horizon for the cluster analysis, the results need to be compared to the 2008 EIS report. In later EIS reports, the grouping of countries altered somewhat, as did the range of indicators, but the sepa-

Table 3.3 Innovation growth

Group	Growth rate (%)	Growth leaders	Moderate growers	Slow growers
Innovation leaders	1.6	Switzerland	Germany, Finland	Denmark, Sweden, UK
Innovation followers	2.0	Ireland, Austria	Belgium	France, Luxembourg, Netherlands
Moderate innovators	3.6	Cyprus, Portugal	Czech Republic, Estonia, Greece, Iceland, Slovenia	Italy, Norway, Spain
Catching-up countries	4.1	Bulgaria, Romania	Latvia, Hungary, Malta, Poland, Slovakia, Turkey	Croatia, Lithuania

Source: European Innovation Scoreboard 2008 (UNU-MERIT 2009:11)

ration of the old, non-Mediterranean from other member states did not. More recent reports will be discussed later.

In examining the literature on innovation (for example, Altuzarra et al. 2007; Bilbao-Osorio and Rodríguez-Pose 2004; Crescenzi 2005), it is noticeable that no matter the basis for the analysis, from a very narrow database to a thoroughly extensive one, the group of old, non-Mediterranean member states is separate from the Mediterranean and NMS. Despite the convergence documented in the EIS report, the second group will long remain far from the innovation-driven, knowledge-based economy that is theoretically the EU's common goal.

In the new, post-socialist member states, FDI plays an undeniably important role in technological development. European research by Srholec (2009), which reaches beyond the boundaries of the EU, reveals that foreign subsidiaries are more likely to be inclined to engage in innovative cooperation with both domestic and foreign partners. With respect to the NMS, Chinkov (2006) came to the conclusion, based on empirical data, that the imported results of foreign R&D play a substantial role in the growth of productivity as a whole, and the growth in domestic R&D is insignificant.

Since the beginning of the 1990s, it has become widespread practice to approach innovation as a system (Asheim and Coenen 2006). The aforementioned research studies also underline what this cluster analysis has shown: not only do the new and Mediterranean member states lag behind the old, non-Mediterranean member states in quantitative terms, but the institutional structure of their innovation systems is different. Rather than the distinction made by Hall-Soskice between incremental and radical innovation, the main source of this difference lies in whether the system of domestic research and development is properly advanced or if innovations enter the economy primarily through foreign companies.

3.3 The Financial System

3.3.1 The Impact of the Financial System on Economic Growth

When analysing the financial system, the main question in the VoC literature is whether financing occurs primarily through the banking system or via financial markets. Of the two definitive works we have highlighted, Hall and Soskice (2001) clearly emphasise this question; Amable (2003), meanwhile, suggests that financial systems tend to use a combination of the two in the wake of the changes that occurred in the 1990s.

At the same time, another question that arises in the literature relates to the degree of influence that the maturity of the financial system exercises over economic growth. In the case of product markets, we observe a fairly broad consensus—subtle differences and finer points aside—regarding the relationship between competition and growth. There is far from common agreement regarding how the maturity of the financial system impacts long-term growth. Here, the lessons to be learned are summarised only in as far as they appear to provide a necessary foundation for my study.

Demirgüç-Kunt and Levine (2008) provide a thorough review of the theoretical debates currently under way. From this, it is evident that some studies (for example, important books on the study of economic development) do not deal with the financial system, while others hold that the financial system's importance from the point of view of growth is beyond

dispute. Those authors who ascribe a positive role to the financial system argue that its efficient operation reduces information-related and transaction costs. Such systems not only aid the efficient allocation of capital but also exercise a controlling function in the implementation of investments. The diversification of risks, the mobilisation and accumulation of savings, and the facilitation of transactions have a similarly beneficial effect on economic growth. According to Demirgüç-Kunt and Levine (2008), empirical research—which they also summarise—carries a still more explicit message. In these studies, just as much effort is made to measure the correlation between the maturity of the financial system and economic growth via comparisons between countries as it is on the level of specific industries and companies. Many studies—with no small portion of them emerging from the World Bank and the National Bureau of Economic Research—prove that the depth of the financial system bears a close relation to long-term growth per capita, accumulation of capital, and increasing productivity. During their investigations, authors have also endeavoured to prove that this correlation exists not merely in terms of simultaneity but also on a causal level, at the exclusion of other potential influencing factors (for example, per capita income, education, political stability, and so forth). Examining the Eastern and Central European and CIS countries, Cojocaru et al. (2011) find an empirical justification in the relationship of financial development to economic growth. Taking into account all methodological restrictions and counter-arguments,[2] we accept, for the sake of this analysis, that the maturity of the financial system is an important criterion of an economic model and simultaneously a foreshadower of its development opportunities.

3.3.2 Financial Systems of the Member States

Based on the above, the inclusion of the new, post-socialist member states in the analysis provides justification—beyond examination of the customary, bank, or financial market-based financing—for us to pose the question of how the maturity of these countries' financial systems relates to that of the OMS. The selection of data was determined—and also limited—by which data were fully available with respect to the examined

member states. The maturity of the banking system is revealed in the stock of credits and deposits, as well as in the proportion of bank assets to GDP, while the degree of concentration in the banking sector is also an important attribute. The maturity of the financial market could be measured through the size of the insurance market, investments and pension funds, as well as by taking stock exchange turnover into account.

Belgium, Finland, and Sweden are included in the first cluster, with their moderately developed and fairly concentrated banking systems. The stock market is well developed in these countries, with significant turnover, revealing a significant difference compared to the fifth cluster, containing most of the OMS. Of institutional investors, insurance companies hold average assets, while the assets of investment and pension funds are somewhat below average.

As before, Luxembourg is in a special situation, forming a separate cluster of its own. Unsurprisingly, a large amount of foreign savings is deposited in the bank system, while the stock of credits and deposits is very high. The same is true of the size of investment funds. At the same time, stock exchange turnover is very low.

The third, large cluster is made up of the NMS, which does not appear in such unified isolation from the OMS even in other subsystems examined. Every element of these countries' banking systems and financial markets is far less developed than those of the OMS. This lack of development is relatively less pronounced in the case of the banking system and greater in terms of the assets of institutional investors, stock market capitalisation, and, particularly, stock market turnover. The concentration of credit institutions (according to the Herfindahl index) is higher, particularly in comparison to the fifth cluster, which contains the majority of the OMS.

The fourth cluster comprising the UK and the Netherlands shows the same specific attributes usually ascribed to the Anglo-Saxon model; namely, a developed financial market and high-turnover stock exchange. At the same time, it is worth noting that bank systems here also appear to be more developed than those of the other OMS. The latter's underdevelopment in the area of financial markets is even greater, however. The concentration of the banking system is average among the 25 member states examined. The amount of assets of insurance companies in propor-

tion to GDP is average, while investment and pension funds are larger compared to all the other clusters (with the exception of Luxembourg).

Nine OMS compose the fifth cluster: Austria, Denmark, France, Greece, Ireland, Germany, Italy, Portugal, and Spain. Interestingly, although these countries' banking systems are well developed, their stock of credits and deposits in proportion to GDP is less than that of the fourth cluster. The banking systems are less concentrated. Assets of insurance companies in proportion to GDP are average, while investment and pension funds are below average. The development of the stock market is somewhat above average in these countries but falls significantly short of the fourth cluster (Table 3.4).

In the two-dimensional MDS diagram (Fig. 3.3), the development of the banking system is represented on the horizontal axis and that of financial markets on the vertical axis (S-stress: 0.036).

Conclusions similar to those revealed by this cluster analysis can be found in the literature in descriptions of the financial system of the EU. Allen et al. (2005) completed a study of the financial system of the then EU-25, determining that it is bank-based, in contrast to the considerably smaller financing role played by banks in the USA, where stock market financing plays a significantly greater role. Thanks to the mergers and acquisitions that have taken place since the turn of the millennium, the European banking system has become highly concentrated. Fundamental differences exist among the EU member states, however. While the UK is traditionally an exception, the Netherlands, Finland,[3] and Sweden have lately shifted towards a market-based financial system. Owing to monetary integration, there has been a movement towards the Anglo-Saxon model in the EU monetary system as a whole, albeit accompanied by the dominance of bank-based financing. In addition to being noted in the studies cited by Allen et al. (2005), this shift is confirmed by Murinde et al. (2004). In implementing directives serving to liberalise EU financial markets during the 1990s, the German government adopted a series of economic policy measures to increase the role of the financial market. Vitols (2004) finds that, due to the conservative, risk-averse behaviour of households and investors, the role of the banking system nonetheless remains significant. Studies discussing the new, post-socialist countries devote much space to an aspect that is also striking in

Table 3.4 Financial system clusters

	Clusters	
1.	Moderately developed banking system Above-average bank concentration Insurance companies with average assets,investment and pension funds somewhat below average Well-developed, high-turnover stock market	Belgium, Finland, Sweden
2.	Developed banking system, particularly high stock of deposits Well below-average bank concentration Huge investment funds, insurance companies High level of stock exchange capitalisation alongside low turnover	Luxembourg
3.	Underdeveloped banking system compared to average, with modest stock of credits and deposits Somewhat above-average bank concentration Significantly below-average assets of institutional investors and insurers Underdeveloped stock market with low turnover	Bulgaria, Czech Republic, Estonia, Poland, Latvia, Lithuania, Hungary, Romania, Slovakia, Slovenia
4.	Developed banking system with extensive lending Average bank concentration Well-developed investment and pension funds, average assets of insurance companies Developed stock market with high turnover	UK, Netherlands
5.	Below-average bank concentration Insurance companies with average assets and below-average pension and investment funds Development of stock market somewhat above average	Austria, Denmark, France, Greece, Ireland, Germany, Italy, Portugal, Spain

this cluster analysis, namely, the insufficient development of these countries' financial systems. The other major theme is the privatisation of the banking system in this region, as a result of which foreign-owned banks assumed a decisive role.

Allen et al. (2005) compare the total assets of the financial sectors of the eight NMS (which did not include Bulgaria or Romania at that time) with that of the OMS, finding that the former amounted to 170 per cent of GDP in 2002, compared to 558 for the latter. Every approach

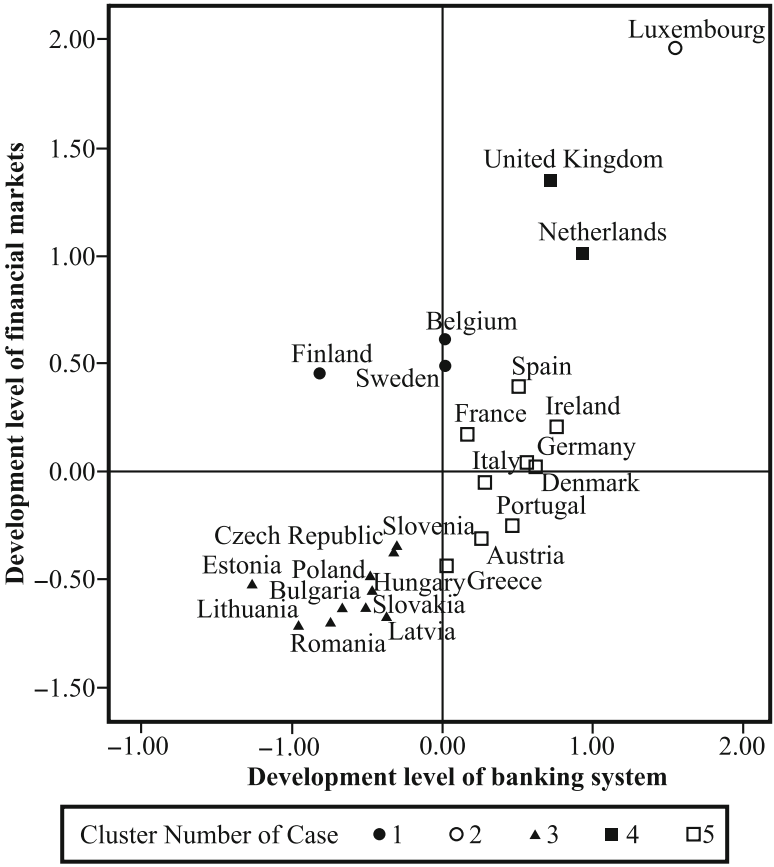

Fig. 3.3 Two-dimensional MDS-based representation of the financial system

to the subject highlights the immaturity of the banking sector in terms of the stock of domestic credit compared to GDP, whether weighing the first decade of financial transformation in the three Central European countries of the Czech Republic, Poland, and Hungary (Reininger et al. 2002), reviewing the banking system of the Baltic countries (Köhler et al. 2006), or presenting the status of the ten post-socialist member states' banking systems prior to accession to the EU (Pissarides 2004). In the first decade following the change in the political regime, these states did

not approach the international average of medium-income countries (De Haan and Naarborg 2004), but in 2002, an energetic process of convergence began (Marton and McCarthy 2008). At the same time, Pissarides (2004) calls attention to the fact that, even in the NMS, the role of banks is greater than in the USA.

The above authors also unanimously observe that stock exchanges are modest in proportion to those of the OMS (one-third their size, on average), while insurance companies,[4] investment funds, and pension funds are of marginal significance.

The venture capital sector underwent dynamic growth in the Central and East European region until 2007, but even so, its proportion to GDP lagged significantly behind the EU average, at approximately 60 per cent. Risk capital arrived in the region almost exclusively from foreign sources (Karsai 2010).

Descriptions of the foreign acquisition of ownership in the banking systems of the post-socialist countries have received great emphasis not only in the history of individual groups of countries prior to EU accession (Reininger et al. 2002; Köhler et al. 2006) but also in the 2008 report of the ECB (European Central Bank 2008), which devotes a separate chapter to the internationalisation of the EU banking system. The authors of this report ascertain that the degree of internationalisation differs substantially between the EU-15 and the NMS, as in the former, some 27.8 per cent of total bank assets are in foreign hands, while the corresponding figure in the NMS is 70.3 per cent [with only Slovenia retaining two-thirds of domestic ownership (Marton and McCarthy 2008)]. In the NMS, the high ratio of foreign ownership is paired with a very low level of diversification (Schoenmaker and Wagner 2011). Because of a dearth of capital and shortage of management and technical skills, the privatisation of the banking sector was unavoidable in the 1990s. Freed of the bad loans inherited from the old regime, the banking system became profitable after the turn of the millennium: for example, at that time, 30–70 per cent of the pre-tax profits of Austrian banks, but only 5 per cent of their total assets, derived from Central and East Europe (Mihaljek 2004). Based on 2002 data, Mucci et al. (2004) prove that foreign ownership has a beneficial impact on the profitability of the banking system and supports cost efficiency.[5]

3.4 The Labour Market and Industrial Relations

3.4.1 Labour Market Institutions and the Performance of the Labour Market

As a criterion for distinguishing between a liberal and coordinated market economy, Hall and Soskice (2001) choose the method of organising employment, which, in the former, is based on individual, market-based contracts and, in the latter, on bargaining between employer and employee bodies and the resultant collective contracts. Amable (2003) isolates three aspects of labour market institutions. He measures the flexibility of the labour market through employment protection legislation (EPL), while analysing both the institutional framework of industrial relations and the set of tools utilised in employment policy.

It is well known that from the mid-1970s, the member states of European integration were stricken with severe levels of unemployment.[6] It became a generally held conviction that increased flexibility in the labour market was indispensable in order to promote job creation. The focus of empirically grounded investigations since the turn of the millennium is no longer on verification of this correlation, but rather on the relationship between the labour market and the deregulation of product markets. In this thematic area—just as in the theme of product markets—the intellectual influence of the research unit operating under the aegis of the OECD is definitive. It is here that the indicators generally applied in the literature were elaborated and measured. Nicoletti and Scarpetta (2005) analyse the relationship between product market reforms and employment in the OECD countries, building partly on the theoretical model of Blanchard and Giavazzi (2003), already mentioned in the above, and expanding partly on their earlier empirical investigations carried out together with Boeri (Boeri et al. 2000). They provide a comprehensive picture of the results achieved in the literature thus far; accordingly, based on theoretical models that deal with product market regulation, it can be presumed that regulations limiting competition result in employment losses. Empirical analyses have strengthened this assumption. Many

studies demonstrate that a high tax wedge and high, long-lasting unemployment benefits have a negative effect on employment. The situation with regard to EPL is not entirely unambiguous. Job security and an enduring working relationship can enhance an employee's inclination to cooperate and increase productivity. Very rigid regulation, however, may actually lead to a lower level of employment. Opinions are divided regarding the nature of the relationship between employment regulations and the institutional system and the degree of centralisation of collective wage bargaining. Nicoletti and Scarpetta (2005) base their analysis of the experiences of OECD countries on data from the 1980–2002 period, reaching the conclusion that the evolution of the employment rate is attributable partly to the variety in labour and product market regulations. Restricting competition significantly reduced the employment rate in the OECD countries. Anti-competitive regulation proved the most costly from the point of view of employment wherever labour market policies and institutions protected those inside the labour market and increased their bargaining power. The beneficial effect of deregulation on long-term employment derives from the observation that, on the one hand, labour market activity and entries increase, while on the other hand the gap between wages and productivity decreases and insiders lose their opportunity for rent-seeking. (In the short term, as Blanchard and Giavazzi (2003) show, the strengthening of competition may lead to a decline in employment at incumbent companies.) An interesting partial finding is that employment gains only slightly decreased if the tax wedge was reduced, and the EPL was relaxed while generous unemployment benefits were left unchanged (the Danish "flexicurity" system). It has also been established that deregulation of rigid markets brings greater benefits. Berger and Danninger (2006) determine that market deregulation leads to significant employment growth, and they also hold that product market deregulation is more efficient in conjunction with less restrictive labour market policies. Fiori et al. (2008) reconfirm the 2005 analysis of Nicoletti and Scarpetta on the issue under discussion.

The research team of Amable and Lung (2008) reach a different conclusion using the same OECD data. They find that competitive restrictions on product markets and highly organised trade unions have a detrimental effect on employment, but that EPL does not. Their explanation for this

finding was that on deregulated labour markets, the uncertain situation of employees can be offset with higher wages in order to maintain motivation, which reduces employment.

The study by Boeri (2005) sheds light on why we find more complex institutional solutions and less clear-cut results in examining labour markets than in the case of product markets. From the appraisal of two decades of European structural reforms, it emerged that labour market reforms were more frequent than those of product markets, but that the latter were more coherent. In the case of the labour market, reforms can be more readily accomplished politically when introduced gradually and initially applied only to new entrants. This staggered approach cannot be implemented on the product market, as it would put incumbent companies in a more advantageous position from which they might drive out new entrants.

In addition to the deregulation of the labour market, active employment policy is used at both the EU and the national levels to counter stubbornly high unemployment in Europe. One research study covering five European countries examined the impact of active employment policy. Both the summary study and case studies pertaining to individual countries show that an active employment policy helps reduce unemployment, including long-term joblessness, but in a comparatively inefficient manner (De Koning and Mosley 2001), which indicates that the mode of implementation of such schemes is in need of improvement.

Storm and Naastepad (2009) examine the relation between labour market regulation and labour productivity based on OECD data from between 1984 and 2004. They reach the conclusion that growth in labour productivity is greater in more regulated labour markets. They explain this conclusion by observing that, with greater job security, workers play a more active role in contributing to organisational and technological innovation. Schaik and Klundert (2009), who analyse the period between 1960 and 2005, find the protection of employees beneficial only between 1960 and 1980—in the period of technological copying and imitation; after 1980, as the role of innovation grew, protecting "insiders" on the labour market had a productivity-reducing effect. Vergeer and Kleinknecht (2010–2011) demonstrate, again for the 1960–2005 period, that job creation deriving from deregulation went hand in hand

with a declining rate of labour productivity growth because the new jobs were created in areas of lower productivity.

Based on the above, it can be seen clearly that from the point of view of employment and the performance of labour markets, labour market flexibility, industrial relations, and employment policy are decisively influential factors and, therefore, are justified as the basis for the formation of clusters. At the same time, it has been found that, compared to the other subsystems discussed in this study so far, each author's choice of values and general outlook is more conspicuous, and the results attained more contradictory.

3.4.2 Labour Markets and Industrial Relations in the Member States

I examine labour markets in connection with employment policy and industrial relations. Labour market flexibility is measured partly in terms of the proportion of employees in fixed-term or part-time employment, the proportions of young people and long-term unemployed, and the level of employment, and partly with indices formed in the World Bank's "Doing Business" survey (World Bank 2007a) related to the rigidity of employment. The data on public expenditures in employment policy are broken down by types of labour market policy measures, separating labour market information services, activation measures and passive means of support. Industrial relations are characterised by the level of trade union density, extent of wage bargain coverage, and degree of coordination in wage bargaining.

From the cluster analysis, it emerges that the 25 examined EU member states can be sorted into five clusters. With the exception of Slovenia, all the post-socialist countries combine with Greece and Italy to form one cluster. In these countries, the ratio of those in fixed-term or part-time employment is low, the rigidity of employment is moderate, and non-wage labour costs are slightly above average. Little is spent on active or passive labour market policy. Not only is there a low level of trade union density, but also the extent of wage bargaining is insignificant. The extent

and degree of coordination of wage bargaining is stronger in the two Mediterranean countries. The level of employment is below average.

In the second cluster, the two Scandinavian states, Denmark and Sweden, appear alongside Belgium. The labour market shows flexibility similar to the Anglo-Saxon model, but the state spends generously on both active and passive labour market policy measures. This is accompanied by a comparatively high level of trade union density and a wide-ranging system of wage bargaining. The level of employment is high. In the case of Belgium, however, data for employment and joblessness are considerably less favourable than in the other two countries.

The third cluster contains the Netherlands alone and is similar to the preceding cluster. In this case, however, the proportion of those in fixed-term and particularly part-time employment is even higher than in the second cluster, while there is a lower amount of public expenditures on active labour market policy and greater spending on passive measures. Though trade unions are not highly organised, wage bargaining is widespread and coordinated. The labour market is flexible, and the level of employment is high.

The fourth cluster comprises the continental and Mediterranean countries (Austria, Finland, France, Luxembourg, Germany, Portugal, and Spain), as well as one former socialist country, Slovenia. In these countries, the labour market is more rigid compared not only to the Anglo-Saxon model but also to the second and third clusters. The proportion of those employed on fixed-term contracts is high, and that of part-time workers is moderate, but indices measuring the rigidity of employment show high values, while non-wage labour costs are similarly elevated. Spending on active labour market policy is moderate, and it is high on passive measures, but it still falls short of that of either the second or third clusters. Trade unions are only moderately organised, but the system of wage bargaining is widespread and coordinated. Both employment and joblessness are around the EU average.

The UK and Ireland show the textbook characteristics we expect from the Anglo-Saxon model. The proportion of those working on fixed-term contracts is low, while the number of those employed part-time is very high; overall, the employment indices reveal an extraordinarily flexible labour market. Labour market policy expenditures are very low, except

those devoted to information services. Although trade unions are moderately organised, wage agreements are not widespread. The employment level is high (Table 3.5).

In Fig. 3.4, countries form groups based on indicators showing industrial relations and public spending on labour market policy measures (vertical axis) on the one hand and on the other hand the flexibility of the labour market (horizontal axis) (S-stress: 0.066).

Measurements made using various indicators have failed to reflect an institutional peculiarity of labour markets in the continental and Mediterranean

Table 3.5 Labour market and industrial relations clusters

	Clusters	
1.	Low proportion of workers in fixed-term or part-time employment Low-level trade union density, with weak collective wage bargaining, though stronger in two Mediterranean countries Rigidity of employment and somewhat above-average non-wage labour costs	Bulgaria, Czech Republic, Estonia, Greece, Poland, Latvia, Lithuania, Hungary, Italy, Romania, Slovakia
2.	High proportion of workers in fixed-term or part-time employment Highly organised trade unions, with widespread collective wage bargaining Flexible employment regulations, and slightly above-average non-wage labour costs	Belgium, Denmark, Sweden
3.	Proportion of workers in fixed-term and particularly part-time employment Low-level trade union density, with widespread collective wage bargaining Flexible employment regulations, low non-wage labour costs	Netherlands
4.	Moderate proportion of workers in fixed-term and part-time employment Moderately organised trade unions, with widespread collective wage bargaining Rigid employment regulations and average non-wage labour costs	Austria, Finland, France, Luxembourg, Germany, Portugal, Spain, Slovenia
5.	Moderate proportion of workers in fixed-term and part-time employment Moderately organised trade unions, with weak collective wage bargaining Flexible employment regulations, with low non-wage labour costs	UK, Ireland

countries to which the literature on labour markets ascribes great significance; namely, the segregated nature of the labour market as evidenced in the varying levels of protection for labour market insiders and outsiders. We will return to this question when discussing the individual models.

The grouping of countries obtained above roughly approximates the grouping contained in the report of the European Commission: Industrial Relations in Europe 2008. Based on the VoC literature, the authors describe the regimes of industrial relations (Table 3.6), with the borderline cases featured in parentheses.

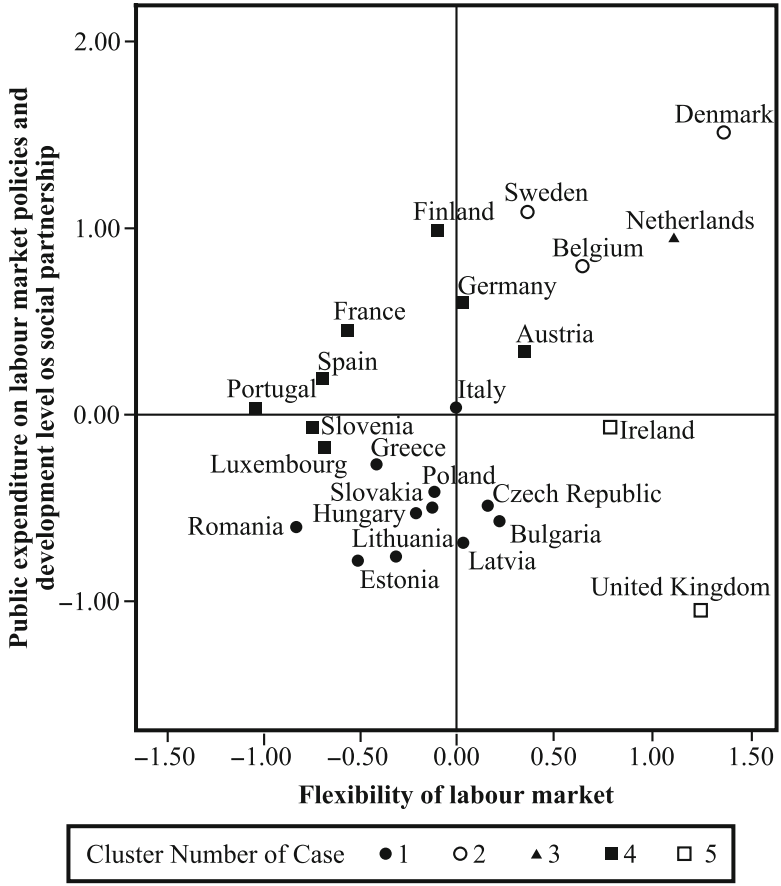

Fig. 3.4 Two-dimensional MDS-based representation of labour markets and industrial relations

Table 3.6 Industrial relations regimes or arrangements

	North	Centre-west	South	West	Centre-east
Production regime	Coordinated market economy	Coordinated market economy	Statist market economy	Liberal market economy	Statist or liberal?
Welfare regime	Universalistic	"Segmented (status-oriented, corporatist)"	"Segmented (status-oriented, corporatist)"	Residual	Segmented or residual?
Employment regime	Inclusive	Dualistic	Dualistic	Liberal	Liberal
Industrial relations regime	Organised corporatism	Social partnership	Polarised/ state-centred	Liberal pluralism	Fragmented/ state-centred
Power balance	Labour-oriented	Balanced	Alternating	Employer-oriented	Employer-oriented
Principal level of bargaining	Sector	Sector	Variable/unstable	Company	Company
Bargaining style	Integrating	Integrating	Conflict-oriented	Conflict-oriented	Acquiescent
Role of social policy in public policy	Institutionalised	Institutionalised	Irregular/politicised	Rare/ event-driven	Irregular/politicised
Role of state in industrial relations	Limited (mediator)	Shadow of hierarchy	Frequent intervention	Non-intervention	Organiser of transition
Employee representation	Union-based/high coverage	Dual system/high coverage	Variable	Union-based/ small coverage	Union-based/small coverage
Countries	Denmark, Finland, Norway, Sweden	Belgium, Germany, (Ireland), Luxembourg, Netherlands, Austria, Slovenia, (Finland)	Greece, Spain, France, Italy, (Hungary), Portugal	Ireland, Malta, Cyprus, UK	Bulgaria, Czech Rep., Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovakia

Source: European Commission (2009c: 49)

Differences between the Commission's analysis and my own relate mostly to uncertain borderline cases. Moreover, I combine the three dimensions into my cluster analysis, whereas the Commission report addresses industrial relations, only including other labour market projections via the Lisbon Strategy in its qualitative examination.

One borderline case is Ireland (Table 3.6). In this analysis, too, it is clear from the MDS diagram that the UK and Ireland, though quite different, can still be grouped in the same cluster.

The other marginal case is Finland, whose labour market is considerably less flexible than those of the two Scandinavian nations, and that, for this reason, is omitted from the Nordic cluster, which nevertheless includes Belgium, in this analysis. According to indices of EPL in the World Bank database ("Doing Business"), Belgium's labour market is exceedingly flexible; however, employment data do not justify including the country's institutional system in the cluster of Nordic countries. Looking more closely behind the data, the labour market is extremely segregated at the regional level. At the beginning of the 1980s, unemployment rates were still similar, but the regions have since strongly diverged, with the Flemish region falling below the EU-15 average, close to the Dutch level, while the Walloon and Brussels-Capital regions are considerably higher than the EU-15 average. In addition, mobility among the regions is extremely low (Estevão 2002) and did not change in the 2000s.[7]

According to my analysis, the Netherlands is a "separate case", clearly isolated from the continental countries and much more similar to the Scandinavians. This finding coincides with a common approach in the literature, which describes the Dutch solution as the polder[8] model, essentially meaning a consensus among social partners with the participation of the state. Following the crisis of the 1970s, this consensus played a major role in helping the Dutch economy embark on dynamic growth from the 1980s onwards. This type of corporatism is more limited and random than previously (De Beus 2004; Hemerijck and Sleegers 2007; Wolinetz 2001).

In the description of the Southern countries in the Commission's report, the categorisation of variable or unstable features several times (Table 3.6), signifying a quite heterogeneous group of countries. It is not surprising that in my study, the Mediterranean countries are divided

between the clusters of old continental and new, post-socialist nations (Table 3.5). France, however, belongs in this analysis—similar to the findings of Sapir (2006) and Amable (2003)—to the continental cluster (Table 3.5) and to the group of countries termed Centre-west in the Commission's terminology. At the same time, there is no doubt that in the conception of the state's role and of competition policy, there is an essential difference from Germany, for example (Aiginger et al. 2007). Presumably thanks to the unified internal market, these differences could not be measured in the product market cluster.

It is interesting that Hungary appears as a borderline case in the Commission report in proximity to the Mediterranean countries. In contrast, both Berrou and Carrincazeaux (2005) and Cazes and Nesporova (2007) regard the Hungarian employment regime as one of the most liberal among the post-socialist nations.

Question marks are attached to the group of post-socialist countries in the Commission report, as the authors believe it cannot yet be known which characteristics will prove enduring. For this reason, it is worth looking at what kind of viewpoint can be shaped based on the literature. The most striking feature of the labour markets of the new, post-socialist member states is what everyone mentions first; namely, the low level of employment and activity. Initially, this low level was regarded as a concomitant of the transition, but it has remained comparatively low even in countries that subsequently underwent dynamic economic growth. Moreover, beginning in 1999, employment grew at a faster pace in the OMS than in the new members (Fialová and Schneider 2008). Certain structural peculiarities of both employment and joblessness are also repeatedly mentioned, including the exceptionally high level of unemployment among the young and low-qualified and the major disparities in joblessness within each individual country, which even the mobility of the workforce does not reduce (Cazes and Nesporova 2007; Rashid et al. 2005; Schiff et al. 2006).

Opinions differ regarding the causes of the enduringly low level of employment and its correlation with the institutional regime. Rashid et al. (2005) believe the root of the problem is that convergence in the CEE countries began with productivity growth, which brought higher wages but did not create jobs. Feldmann (2004) blames the inflexibility

of labour markets, while Fialová and Schneider (2008) point to greater flexibility in EPL in the NMS compared to their older counterparts. Schiff et al. (2006) state that the CEE places rank in the middle among industrialised countries in terms of the flexibility of EPL. In their view, a lower EPL value correlates with a smaller shadow economy, and for this reason, International Monetary Fund (IMF) researchers recommend further liberalisation of the labour market. However, Cazes and Nesporova (2007) demonstrate that, in contrast with the OECD countries, in the CEE countries, stricter EPL increases employment. Their explanation for this is that stricter legal regulation whitens the economy, which is manifested in growth in formal employment. Both IMF and International Labour Organisation researchers agree that cutting taxes on labour and an active employment policy can have a significant impact on employment growth.

In describing industrial relations in the new, post-socialist member states, we encounter an unambiguous situation, as reflected in the literature. After the change in the political system, with the liquidation of large socialist-era companies and privatisation, the level of trade union density declined substantially and both remaining and new trade unions lent their tacit support to painful reforms that were regarded as unavoidable. Employers' organisations, meanwhile, did not exist and had to be created from scratch. Collective bargaining is decentralised, and trade unions refrain from taking action even when problems arise in the enforcement of collective contracts. Dimitrova and Petkov (2005) observe that values, basic principles, and standards in the area of industrial relations in the NMS are markedly different from the European social model, which may undermine the prospect that the social aspect of expansion will proceed in a European direction. The Commission's 2008 report on industrial relations likewise stresses, if in somewhat more tactful terms, that the EU's eastward expansion has aggravated differences strongly, although it tends to place greater emphasis on convergence arising from common EU regulations.[9] In any event, strong trade unions did not stand in the way of market deregulation, which did not help create jobs, as might have been expected based on theoretical correlations.

Taking the examples of Poland and Hungary, Sissenich (2007) examines how the regulations of EU social policy were transplanted and what

role was played by non-state actors in this process. From this research, it emerges that both employers' and employees' organisations not only in these two countries but also in the other post-socialist countries were largely uninvolved or only moderately involved in the process of adaptation. These organisations failed to take advantage of the EU's social dialogue to at least assert their preferences, even if accession did not occupy them particularly. The author explains this finding by noting that membership in both trade unions and civil organisations in general is considerably smaller in the post-socialist countries than in the OMS, such that mediating organisations are weak and protest action is rare.

Only in Slovenia have industrial relations evolved in a way that permits integration with the models of the OMS. Here, trade unions obtained a powerful role, despite a similarly declining level of trade union density. Alone among the post-socialist countries, Slovenia is included among the old continental member states both in the Commission's report (Table 3.6) and my analysis (Table 3.5). This separate path was made possible by two factors: on the one hand, Slovenia did not carry with it significant foreign indebtedness through the change of system; on the other hand, thanks to the Yugoslav system of workers' self-management, the workforce began from a much better position—and with much greater experience in advocating their interests—than in the other post-socialist countries (Stanojevic 2005).

To summarise, the examination of labour markets reveals that a high level of employment can materialise under very different institutional arrangements. I discuss the significance of these institutional differences from the point of view of social models of European capitalism in the next point.

3.5 Social Protection and the Welfare State

3.5.1 The Sustainability of the Welfare State

Even with the subsystems already discussed, it has been no simple task to concisely summarise the theoretical background and empirical

results provided by macroeconomics to aid this comparative economic investigation. The questions that revolve around the welfare state and social protection present a more difficult task than any that has come before.

Hall and Soskice (2001) place the focus so much on the system of production and enterprise that the welfare state does not feature at all in their idealised types of liberal or coordinated market economies. However, taking the criticisms into account, Soskice (2007) expands on these models by including the welfare state and political regime alongside the systems of production. Amable (2003) features social protection as a separate subsystem. Although the discussion of the disputed nature of the European social model cannot be elaborated here, it is beyond debate that the clearest distinguishing feature of the apparatus of European countries compared to other developed capitalist economies is a firmly established welfare state, making it inevitable that it will be analysed as a separate subsystem.

In the discussion of labour markets, it was previously evident that any examination of the economic context would unavoidably touch upon sensitive questions of social policy. The welfare state falls at least as much within the terrain of the sociologist or political scientist as within that of the economist. It is impossible to provide a picture of the arguments over the welfare state that rage within the various branches of scholarship because it would demand a book of its own. Just as with the other subsystems, here, only research studies that bring us closer to mapping out the types of capitalism that exist within the EU will be assessed. Some of the literature dealing with models of capitalism speaks of social protection, some of the welfare state; however, these concepts are not sharply divided. For example, Amable (2003) writes of social protection but compares his own models with those of Esping-Andersen (1990), who defines welfare state regimes. It can be seen that those who approach the issue from the perspective of sociology, social policy, political science or political economics tend to use the broader term of the "welfare state", while those who carry out statistical investigations aiding macroeconomic or comparative economic modelling tend to opt for "social protection". In the case of macroeconomic analysis, social protection can easily be grasped

through social expenditures; moreover, the OECD has a well-structured and defined database.

The most common explanation for the creation of the welfare state, widely put forward in the 1960s and 1970s, derives from functionalist sociology; namely, the welfare state provided an answer to the social problems and opportunities that arrived with industrialisation. The school of conflict theory traces it back to political factors and social movements. Since the economic crisis of the 1970s, criticism has intensified, and the most vexing question now—in the age of globalisation, in post-industrial and simultaneously ageing societies—is whether the welfare state can be sustained (Jæger and Kvist 2004; Kleinman 2002). In any event, despite every challenge, the welfare system has stubbornly survived and the average level of welfare expenditures has not decreased either in the OECD countries or the EU (Arjona et al. 2001; Jæger and Kvist 2004).

Genschel (2004) considers the various viewpoints regarding the connection between globalisation and the welfare state in turn. Globalists regard the crisis of the welfare state and its shrinking as part of a convergence process as a direct and inevitable consequence of internationalisation. Sceptics hold that no evidence supports the view that global interdependence restricts national political autonomy, observing that welfare states have not decreased in size and that differences between nations have remained. A third, so-called revisionist trend states simply that globalisation can help resolve the problems of the welfare state that originate in the welfare state itself. The disciplining power of international markets can make it easier for governments to rein in welfare expenditures that are susceptible to a dynamic increase. Taking into consideration the theoretical arguments and empirical research, the author determines that in the era of globalisation, there is no clear way out for the welfare state, while governments have possible choices. Iversen (2005) also refuses to hold globalisation responsible for the decline in welfare provision in developed countries. Instead, he attributes this decline to the diminishing contribution of the industrial sector to GDP, which has occurred in such a way that new jobs have been created mostly in services of low added value that play no role in foreign trade.

A wealth of macroeconomic models and empirical research has been used to evaluate how economic growth relates to social protection and

income disparities. Aronja et al. (2001), besides constructing their own model, digest and process the findings obtained thus far. The most frequent argument put forward against equality in economic theories is that savings are lower in a more egalitarian society, slowing economic growth. As the income disparities between employment groups increase, people will strive more to gain qualifications that secure jobs with high productivity and, hence, high wages. Arguing against inequality, others observe that poorer households are unable to invest even from credit—particularly in human capital—which is detrimental from the point of view of growth. With major inequalities in place, there may be too many people among the voting populace for whom necessary, competition-enhancing economic reforms hold no interest. The likelihood of social and political unrest and tension is similarly detrimental to economic growth. Social protection, however, may harm growth by potentially deterring people from either saving or working for a living. If material benefits can be obtained more effectively by enforcing political interests than through economic activity, this situation might lead to the degeneration of enterprise and innovative capacity. The advantage of strong social protection is firmer social cohesion, where it is easier to make difficult political and economic decisions (for example, on structural adjustments); certain social groups are not excluded from the majority of society, nor from opportunities to participate in the labour market, thus increasing economic potential; and children from poorer social strata also have a chance to secure their long-term social and intellectual development.

Aronja et al. (2001) collected 24 studies from the preceding decade and a half that examined the correlations between growth, social inequality, and social protection. Based on these studies, it is not possible to determine which of the above theories are borne by reality or whether there is a trade-off between growth and social protection and equality or if the latter promote the former because the results of these studies are contradictory. According to these authors' own research built on the OECD database, there is no reliable proof of the relationship between growth and the final distribution of income (after taxes and transfers). It is proven that greater social expenditure goes hand in hand with lower economic growth; in contrast, active expenditures that help people get a job promote growth. These findings suggest a similar conclusion to that

reached by Genschel (2004), namely, that various institutional solutions can prove economically successful.

3.5.2 Social Protection in the Member States

In examining social protection, I am interested not only in the scale of expenditures in relation to GDP but also in their internal structure. The most important items that reflect the distinctive character of each individual system of social protection are old-age provisions and the proportion of child and family support. The sources of financing—state, employer, or beneficiary—likewise reflect essential institutional features. In addition to income disparities and sources of financing, the poverty risk before and after welfare transfers are taken into account.

A cluster analysis of social protection paints a complex picture. In line with expectations, Denmark, Sweden, Finland, and Luxembourg are leaders in guaranteeing social protection. Expenditures are efficient, as income disparities in this group are the smallest, while the poverty risk is the lowest after welfare distribution, despite being above average beforehand. The government takes the greatest share in financing services. It is worth noting that, on the one hand, pensions in proportion to GDP are slightly above the average of the EU-25 states, while on the other hand, the proportion of family and child benefits, as well as support for those living with disabilities, is high within welfare expenditures as a whole.

Of the OMS, Ireland alone has low social and healthcare expenditures. Although disparities in income distribution are moderate, the poverty risk is high both before and after social transfers. The ratio of pensions to GDP is extremely low, due partially to the youth of the population. Consequently, it is also unsurprising that the proportion of social expenditures on the elderly is low within total social spending, and that of family and child support is high. The government plays a conspicuously important role in financing these expenditures.

The next cluster is a very populous one, containing all the continental countries except Luxembourg, together with the Mediterranean countries, the UK, Poland, Hungary,[10] and Slovenia. The level of expenditures

on social protection and healthcare is very similar to the first cluster; that is, it can be described as high. Income disparities are moderate, however, making the poverty risk both before and after transfers similarly around average. The ratio of pensions to GDP is high. Family and child benefits comprise only a small portion of spending on social protection, while provisions for the aged are high. The government makes a smaller contribution to the financing of social protection expenditures, while the contributions of employers and beneficiaries are higher than in the first or second cluster.

The three Baltic states, the Czech Republic, Slovakia, Romania and Bulgaria, make up the group in which social and healthcare spending is the lowest. With the exception of the Czech Republic and Slovakia, disparities in income distribution are the largest here, while the poverty risk is slightly below average before social transfers and above average afterwards. Although the ratio of pensions to GDP is low, the share of family and child support in social expenditures is moderate, and that of provisions for the aged is high. The contribution of employers to spending on social protection is conspicuously high, while the government and beneficiaries contribute relatively little (Table 3.7).

In Fig. 3.5, the horizontal axis indicates the level of development of social protection. The vertical axis permits us to gauge whether old-age and pension provisions or child and family benefits dominate the system of social protection.

On the topic of social protection and the welfare state, the VoC literature is intertwined with the work of sociologists and social policy-makers. In the wake of Titmuss's pioneering works on social policy, Esping-Andersen's book, *The Three Worlds of Welfare Capitalism* (1990), proved to be a milestone. His formulation of three types of regimes—liberal, conservative-corporatist, and social democratic—prompted a long succession of authors who refined or refuted these models or expanded their number. The most frequent alteration was to group the Latin or Mediterranean countries separately (Kleinman 2002). Currently, the division into four models is accepted, and debate tends to focus more closely on the extent to which social policy can be integrated at the European level and on which model is sustainable. Caminada et al. (2010) identify a

Table 3.7 Social protection clusters

	Clusters	
1.	High level of welfare spending Low level of income disparities Within welfare spending, high proportion of family and child benefits High government contribution to the financing of social protection expenditures	Denmark, Finland, Luxembourg, Sweden
2.	Low level of welfare spending High level of poverty risk, with moderate income disparities High government contribution to the financing of social protection expenditures	Ireland
3.	High level of welfare spending Moderate income disparities Within welfare spending, a low proportion of family and child benefits High ratio of pension expenditures to GDP Low government contribution to the financing of social protection expenditures, high contribution by employers and beneficiaries	Austria, Belgium, UK, France, Greece, Netherlands, Poland, Hungary, Germany, Italy, Portugal, Spain, Slovenia
4.	Low level of welfare spending High level of income disparities Within welfare spending, a moderate proportion of family and child benefits Low ratio of pension expenditures to GDP High contribution by employers to financing of social protection expenditures, low contribution by government and beneficiaries	Bulgaria, Czech Republic, Estonia, Latvia, Lithuania, Romania, Slovakia

decade-long convergence among the OMS from the mid-1980s onwards, followed by a divergence thereafter. Pöder and Kerem (2011), as well as Leibrecht et al. (2011), place the countries of CEE in a separate group alongside the aforementioned fourfold division. However, based on their empirical investigations, the former authors find a convergence between the Mediterranean and continental (conservative) welfare regimes, while the latter authors determine a similar convergence between the Nordic (social democratic) and conservative welfare regimes.

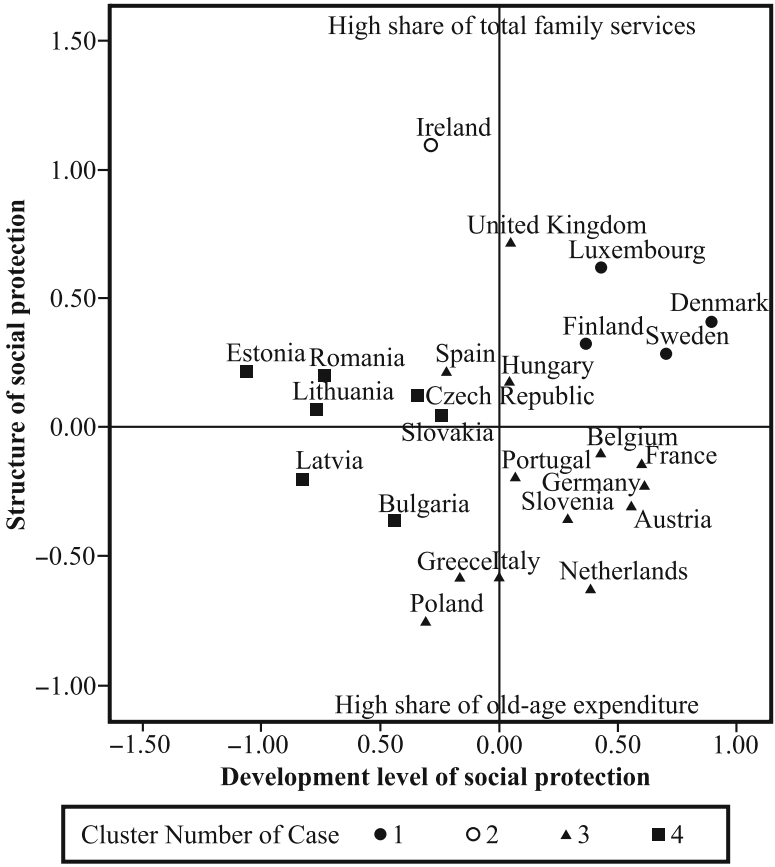

Fig. 3.5 Two-dimensional MDS-based representation of social protection

Within the thematic area of social protection, not only interdisciplinary overlaps but also shared content were found because the topic is closely connected to the labour market. I examine labour market policies and their expenditures separately and, following Eurostat's statistical system, list only direct social allocations among social protection expenditures. In the study by Aronja et al. (2001)—in accordance with OECD data collection—expenditures on active labour market policy are

also included in the latter. Sapir (2006) formulates his social models in two dimensions: welfare redistribution and labour market policy. The overlap is unavoidable because the state's labour market policy and regulation determine the framework for operation of the labour market as a partial market, and they also constitute an important element of social protection.

The picture emerging from this cluster analysis roughly corresponds to what is found on welfare regimes in the literature in the wake of Esping-Andersen. Esping-Andersen himself (1990) explains the variety within welfare regimes not on the basis of differing expenditures in individual states, but rather on the basis of the type of institutional framework through which welfare provisions can be accessed, an approach later reinforced by experience.[11] Indicators used in the cluster analysis, meanwhile, clearly reflect the institutional system that Esping-Andersen attributes in his 2002 study to the Nordic, liberal, and continental models. In his view, the distinctive feature of the Nordic model is that it provides universal income guarantees and well-developed services to children, the disabled, and the elderly in need of support, while its activation policy reduces long-term unemployment.

The cluster of Nordic countries in my analysis is clearly separate from that of the continental countries. The level of expenditures is somewhat higher than the average in the continental countries, although—thanks to the reforms of the 1990s—the quantitative difference is no longer conspicuously great. Structural differences are more noticeable, indicating varying institutional systems. The proportion of old-age provisions is great in the continental countries, conforming to the traditional, status-oriented model that makes it possible to maintain social status throughout the various stages of the life cycle. By contrast, in the Scandinavian countries, family and child support is significant, which—following the universal model—aims to level out income across the family's life cycle in the spirit of an egalitarian ethos. A beneficial effect of this result is that child poverty is negligible. Pension and healthcare expenditures are lower than the EU-15 average. Kiander (2004) explains that healthcare is cheaper than in the other EU member states because it is provided in public institutions, as opposed to the more expensive combination of social insurance and private care. The efficient operation of welfare insti-

tutions and strong competition within the economy can be attributed to the fact that there is a high poverty risk after market income distribution, while the risk will be the lowest among the four clusters after welfare transfers.

The classification of the UK and Ireland among welfare regimes generally elicits uncertainty in the literature. Esping-Andersen (1990) labels the English-speaking countries as liberal, residual welfare regimes, where the ideal type is the USA. From his book, it also emerges that the UK does not entirely fit this model because healthcare is a universal service financed from taxes, just like education. Local governments hold a large supply of rented social housing. In 1990, the author classified the welfare regime in Ireland as belonging to the corporatist-conservative model of the continental countries. A decade later, he assigned both countries—albeit in inverted commas—to the "liberal" welfare model, which, similar to the USA, supports market solutions and limits public accountability to acute market failures. The role of means testing has strengthened, and in parallel, the emphasis has shifted from the traditional assessment of needs to work-conditional welfare provision (Esping-Andersen 2002).

In the cluster analysis, the UK appears as a borderline case among the continental countries. Within the structure of expenditures, the difference compared to the continental countries is apparent not so much in child and family support, but rather in strikingly high housing benefits. The poverty risk and income disparities are high. In the MDS diagram, this ambiguous situation is clearly expressed in the UK's relative separation from the other countries of the third cluster. At the same time, Kleinman (2002) points out that even in the Thatcher era, the welfare regime did not become "truly" liberal; the changes were more radical in rhetoric than in reality. Pierson (1996) attributes this result to resistance in society and political unpopularity forcing governments to backtrack.

In this study, Ireland tends to display the characteristics of an Anglo-Saxon regime like the UK itself. Callan et al. (2008) likewise categorise their own homeland under the Anglo-Saxon model, given that the institutional system resembles that of the UK. They nevertheless note that spending on social protection is not as low as the GDP-proportionate fig-

ure would suggest because, in Ireland's case, there is a large gap between GDP and GNI (in 2004, the latter was just 85 per cent of the former), and GNI is a more realistic basis for comparison. However, even after making this correction, social expenditures are still considerably lower than the average in the OMS.

Esping-Andersen (2002) includes the Mediterranean countries in the continental welfare model, in the majority of which the traditional responsibility of family in the welfare regime has remained, especially in Southern Europe, but to the least extent in France and Belgium. Coupled with this is the dominance of social insurance, which provides good protection for those with a stable job throughout their working lives but which is unable to adequately manage the risks that accompany the spread of atypical employment.

The Mediterranean countries do not stand out among the continental countries in this study (Table 3.7) or in the European Commission report on industrial relations as it relates to welfare regimes (Table 3.6). Studies arguing in favour of an independent welfare regime cite characteristics such as the importance of family in social protection, the inefficient operation of welfare institutions, their clientelist and particularist nature, and the strength of party-political influence (Kleinman 2002). These characteristics naturally cannot be expressed by the indicators used in this analysis. In the past decade, the Mediterranean countries have strived to improve the efficiency and sustainability of their welfare regimes through a series of reforms (Guillén 2007; Sacchi 2007; Sakellaropoulos 2007).

The European Commission report on industrial relations (European Commission 2009c) questions whether the new, post-socialist countries belong to the Anglo-Saxon residual model or to the segmented continental model. This cluster analysis acknowledges that these member states could not be grouped under a single welfare regime (Table 3.7). Poland, Hungary, and Slovenia belong among the continental countries. As can be seen in relation to the transformation in CEE, Poland and Hungary principally owe this "illustrious" position to the fact that they handled the joblessness that came with structural transformation by pensioning people off. The other post-socialist countries, by limiting the role of the state, display more characteristics of a residual regime, although they are

also set apart from this regime by the tradition of continental social insurance, where the contribution of employers to financing is high.

3.6 Education

3.6.1 Education and Growth

From the education system as a whole, Hall and Soskice (2001) incorporate the various forms of vocational training into their models of liberal and coordinated market economies, which is necessary for an examination of the production regime. In the liberal system, general knowledge and skills can be acquired through formal training, as companies are reluctant to invest in their own training because those they train can easily find employment on a flexible labour market. In the coordinated market economy—which the authors describe through the example of Germany—companies provide vocational training, which is overseen by employer organisations and teaches specific knowledge and skills. Estevez-Abe et al. (2001) examine Hall and Soskice's classification of vocational training regimes in liberal and coordinated market economies by extending it to the countries of the OECD. At the same time, they corroborate the complementary institutional similarities between the production regime, the labour market, and vocational training that Hall and Soskice propose with respect to the USA and Germany.

Amable (2003) notes that education systems vary greatly from country to country and that all-embracing comparative analyses are lacking. Most often, the education systems of the English-speaking countries tend to be compared with those of Germany and the Netherlands, with the former characterised by loose—and the latter by strict—standardisation and differentiation. Gangl (2000) regards dual education systems providing trade-specific training as advantageous for young people entering the labour market, such as those functioning in Austria, Denmark, the Netherlands, and Germany. In his analysis, Amable uses a wide range of variables, although he is unable to find reliable, comprehensive data on vocational training.

In neoclassical growth theory, education is a defining element of the economic environment because it develops human capital, which, in turn, increases labour productivity, and consequently—through growth—the equilibrium shifts to a higher output level. Endogenous growth theory not only highlights the power of education to increase innovative capacity but also assigns it an important role in the spread and dissemination of knowledge. A series of macroeconomic investigations have tried to confirm theoretical expectations on an empirical basis, such as Akram and Pada (2009), who completed seven country surveys and apply 14 such research studies to several countries. Although time horizons, the range of countries surveyed, educational segments and applied statistical methods differ, as do the strength and significance of the findings, all the studies unequivocally confirm the significant positive impact of education on economic growth. It is worth noting that, according to calculations by Neycheva (2010), public spending on education contributes more obviously to economic growth in the OMS than in the NMS. Little-known empirical investigations refute the common perception that the education system was of a high standard in the era of state socialism. Skills and qualifications acquired under the previous regime by employees in the European post-socialist countries already lagged behind the average in OECD countries in the mid-1990s (Commander 2007).

Hanushek and Wößmann (2007,2010) point out that surveys generally appraise education using quantitative criteria (enrolment ratios, years spent in school, and so on), although the quality of education can be just as important from the point of view of economic growth. They use the results of international testing to assess the quality of education, including both emerging and developed countries in their investigations. Their analysis proves not only the significant positive effect that quality education exerts on economic growth but also that this effect is relatively meagre in closed economies and substantially greater in open economies. Education's positive economic impact is further enhanced if it is able to function within a productive institutional environment (markets, legal systems, and so on). The authors demonstrate that improving the education system is not merely a financial question, but that greater expenditures bring results only as part of a set of coordinated measures. The key

to reforms is to ensure high-quality teaching staff. These authors also attempt to create models for the long-term growth returns of educational reforms.

3.6.2 Education in the Member States

Participation at the various levels of education, reflecting the scope of the education system coupled with the scale of financing, reveals much about the position and role of education in the economy. At the same time, only a few characteristics of the education system can be outlined based on available statistical data, and the internal structure and qualitative features of individual education systems cannot be described in detail here. Using data for joblessness and employment at the different levels of educational qualification, I attempt to establish the extent to which the education system adapts to the labour market. Both employment and joblessness are naturally also influenced by many other factors, and labour market data thus enable us to draw only limited conclusions regarding the education system.

The cluster analysis produces two truly pronounced groups: the first and second clusters. By contrast, the dividing line between the third and fourth clusters is quite blurred, but drawing them together would have resulted in an overly heterogeneous formation.

The distinctive feature of the first cluster is that employment on the labour market is very high among social groups of varying educational levels and is accompanied by a high enrolment ratio. Austria, Denmark, UK, Finland, the Netherlands, Sweden, and Slovenia belong to this group. The proportion of those with at most a lower secondary education[12] and early school-leavers is below the average for all member states, albeit not the lowest of all. A very large number take part in adult education. The proportion of those with an upper secondary education and—among them—those taking part in vocational training is above average, while the ratio of those enrolled in higher education or holding higher technical or scientific qualifications is the highest of any of the clusters. These countries (primarily the Nordic countries and, to the least extent, the Netherlands) spend the most on education when the expenditure per

student to per capita GDP and overall educational expenditures to GDP as a whole are compared. With one exception,[13] joblessness and employment indicators are the most favourable in this cluster at every level of education. Employment among those with a low-level education is also above the average of all the member states, although this level is exceeded by that for the Mediterranean cluster.

The second cluster consists of three Mediterranean countries: Italy, Spain, and Portugal.[14] The education systems of these countries paint a paradoxical picture, as a somewhat above-average enrolment ratio in higher education is paired with a strikingly high proportion of those with only a low-level education. Considerably fewer people participate in adult education than in the first cluster, but more than in the third or fourth clusters. Although educational spending is below average, it lags significantly behind only the first cluster. The rate of employment among those with a low-level education is the most favourable, while that of people with higher educational qualifications is the poorest.

The third cluster contains Belgium, the three Baltic states, France, Greece, Ireland, Luxembourg, Hungary, and Romania. In these countries, the proportion of those with a low-level education or early school-leavers is around average, as is the ratio of more highly qualified people. However, there are fewer participants in either vocational training or adult education than the EU average. Spending on education is below average according to all examined indicators, except in Belgium, France, and Hungary. Rates of employment among people of all educational levels are slightly below average and unemployment rates around average, except for a lower level of joblessness among the low qualified. Within this cluster, Ireland can "boast" of better employment and joblessness figures than the other countries.[15] Luxembourg is a special case in this regard because many young people complete their studies abroad, particularly in higher education.

The fourth cluster comprises Bulgaria, the Czech Republic, Poland, Germany, and Slovakia. The proportion of low-qualified people is the smallest here, and the number of early school-leavers similarly low, while the proportion of those with at least an upper secondary education and those pursuing vocational training is the highest. The ratio of those

enrolled in higher education is below average, while the number of those taking part in adult education or holding technical or scientific qualifications is the lowest among all four clusters. Public spending on education is the lowest compared to GDP, but private expenditures are the highest. Spending per student in higher education compared to GDP is above average. The rates of employment and joblessness among those with a low-level education are the least favourable, while corresponding rates among the more highly educated are around average.

In this cluster, the deepest traces of the socialist education system can be seen. A large proportion of the population, exceeding levels in Western countries, was successfully enrolled in the education system, and their training served the aims of socialist industrialisation well. However, following the capitalist transformation, even a high level of education does not guarantee a high level of employment within the new economic structure. It can be assumed that Germany appears in this cluster as a consequence of unification (Table 3.8).

The horizontal axis in Fig. 3.6 shows the levels of education found in the individual countries, while the vertical axis shows differences in the rate of employment, where it can be seen that the employment of those with a low level of education has the greatest effect on the position of each country (S-stress: 0.068).

It is interesting to compare our education clusters with the summary of the quality of education in the EU member states provided in the 2006 PISA report (OECD 2007) (Table 3.9). PISA reports are prepared every three years, and in chronological terms, the 2006 data are comparable with the figures in the cluster analysis, although the comparison is limited in its validity because the report provides a picture of the performance of 15-year-old pupils, which can change in the future. Based on the results of the PISA report, the educational performance of the countries featured in the first and second clusters is homogeneous. The first cluster comprises very high-performing countries, while the second contains poorly performing Mediterranean countries. The other two clusters, on the other hand, are heterogeneous, showing major differences in the performance of countries contained within them.

Table 3.8 Education system clusters

Clusters		
1.	Below-average proportion of people with low-level education or early school-leavers, high proportion of people with upper secondary and higher education Very high participation in adult education Highest ratio of education spending to GDP Most favourable employment and joblessness data	Austria, Denmark, UK, Finland, Netherlands, Sweden, Slovenia
2.	High proportion of people with low-level education or early school-leavers Enrolment in higher education somewhat above average Low participation in adult education Below-average ratio of education spending High employment among people with low levels of education, below-average for those with at least upper secondary education	Italy, Portugal, Spain
3.	Roughly average proportion of people with low-level education or early school-leavers, similar to the ratio of people with higher levels of education Slightly below-average ratio of people enrolled in higher education, few participants in adult education Education spending below average according to all examined indicators Below-average employment rates among people of all education levels	Belgium, Estonia, France, Greece, Ireland, Latvia, Lithuania, Luxembourg, Hungary, Romania
4.	Smallest proportion of people with low levels of education, number of early school-leavers low Highest participation in vocational training Lowest proportion taking part in adult education Public spending on education lowest compared to GDP Least favourable employment and joblessness rates among people with low levels of education	Bulgaria, Czech Republic, Poland, Germany, Slovakia

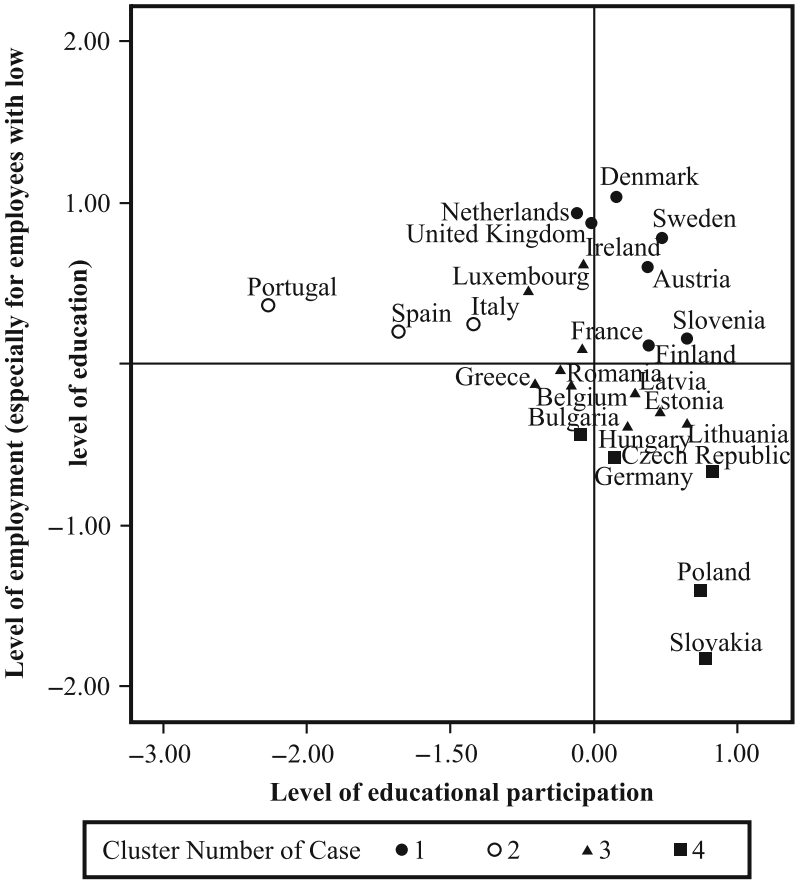

Fig. 3.6 Two-dimensional MDS-based representation of the education system

Table 3.9 Pupils' average scholastic performance based on the 2006 PISA report

Member states	Pupils' average performance		
	Science points	Reading points	Mathematics points
Finland	563	547	548
Estonia	531	501	515
Netherlands	525	507	531
Slovenia	519	494[a]	504[a]
Germany	516	495	504[a]
United Kingdom	515	495	495
Czech Republic	513	483	510
Austria	511	490	505
Belgium	510	501	520
Ireland	508	517	501
Hungary	504	482	491
Sweden	503	507	502
Poland	498	508	495
Denmark	496	494	513
France	495	488	496
Latvia	490	479	486
Slovakia	488	466	492
Spain	488	461	480
Lithuania	488	470	486
Luxembourg	486	479	490
Italy	475	469	462
Portugal	474	472	466
Greece	473	460	459
Bulgaria	434	402	413
Romania	418	396	415

statistically significantly above OECD average

no statistically significant deviation from OECD average

statistically significantly below OECD average

[a] Comparison to OECD average based not only on point scores displayed here

Source: OECD (2007: 24, 52, 58)

Notes

1. For example, the crisis has triggered a major decline in GDP and a leap in unemployment in a state with an underdeveloped social welfare system (such as in the Baltic states), leading to a dynamic growth in welfare expenditures in proportion to GDP, even though this obviously does not signify the beginning of an expansion in the social welfare system itself.
2. Demirgüç-Kunt and Levine (2008) acknowledge that, despite the evidence uncovered, their conclusions must be treated with caution. For example, it seems fair to criticise the fact that the maturity of the financial system can be measured quantitatively only by econometric approaches, revealing nothing about the extent to which banks carry out the task of gathering information during the lending process to help the efficient allocation of capital. The case of China, meanwhile, can be incorporated into their theory only with difficulty.

   Prompting us to exercise caution, for example, is the criticism by Zhu et al. (2004) of an oft-quoted article by Levine and Zervos (1998). The latter proved, based on data from 47 countries between 1976 and 1993, that a developed financial market measured in stock market liquidity, as well as a well-developed banking system measured in the stock of credit against GDP, had a significant and positive impact on GDP growth. Zhu et al. (2004) demonstrate that the authors reached their conclusions with regard to the role of the stock market by omitting outlier values that, if taken into account, would prove the article's conclusions to be false.

   The extensive literature dissects the question of how much the role of legal institutions determines the development of the financial system. Although the former's influence on the latter can scarcely be disputed, opinions about its importance are divided. Beck and Levine (2003) provide a comprehensive picture of this debate.
3. Korhonen (2001) presents the transformation of the Finnish financial system.
4. Pye (2005) examines the transformation of the insurance sector in all the former socialist European countries and the CIS member states alike, demonstrating both the relative underdevelopment of the region as a whole and the differences in development between the countries concerned.

5. Kasman and Yildirim (2006) paint a more nuanced picture of the period from 1995 to 2002, finding that while the profit efficiency of foreign banks in the CEE countries as a whole was greater than that of domestic banks and that foreign banks performed better in terms of cost efficiency in the Czech Republic and the three Baltic states, the performance of domestic banks in the latter regard was better in Hungary and Poland, while no significant difference was observable in Slovakia and Slovenia.
6. Cameron (2001) provides a historical overview of unemployment from the 1970s onwards and its differing evolution in the various member states. The conclusion from this overview is that the level of employment was higher in member states where economic growth was also greater, where employer and employee bodies reached new, more flexible agreements, and where governments pursued job-creating economic policies.
7. For example, in 2007, the Flemish region faced a 72.3 per cent employment rate and 3.9 per cent unemployment, as opposed to Brussels' 60.2 per cent employment and 15.9 per cent unemployment and the Walloon region's 62.8 per cent employment and 10.0 per cent unemployment (European Commission 2010b).
8. A polder is a tract of land artificially reclaimed from the sea and enclosed by dikes. If cooperation is lacking in maintenance of the dikes or a section of dikes is neglected, the whole area may be inundated. The Dutch consensus-based decision-making model is traced back to this historical precedent.
9. O'Hagan (2002) highlights the barriers to convergence in her book. Ireland (described as being on the semi-periphery) and Hungary (then still a candidate EU member) achieved their successes in the 1990s by taking the "low road" to competitiveness (with a comparatively well-trained workforce, low wages and an FDI-dependent labour market), while the European social model builds on the "high road", based on the manufacture of top-quality products in the countries of the centre. For this reason, it is not surprising that, even exploiting the opportunities of flexible introduction, EU legislation has not brought a breakthrough in industrial relations in either Ireland or Hungary.
10. With regard to spending on social protection, Hungary and Poland are last in line within the cluster, but their institutional systems as a whole nevertheless place them in this group.

11. Historical experience shows there is not necessarily a connection between the level of welfare expenditures and the institutional arrangement. On the one hand, market solutions can prove relatively very costly: in 2007, the USA spent 16 per cent of GDP on healthcare, compared to 8.2 per cent in Finland, for example. On the other hand, for example, in Sweden, universal healthcare and pension provision came about irrespective of whether 11.3 per cent (1950) or 40.1 per cent (1990) of GDP was spent on social protection. They did not renounce the philosophy of their social institutional regime even when the level of state expenditures compared to GDP was whittled down from 70 per cent (1994) to 54.4 per cent (2001). The adjustment of social spending to the economy's current load-bearing capacity does not therefore determine the accompanying institutional regime (data source: OECD Stat, Tomka 2008).
12. When analysing the education system, I applied the categories of the International Standard Classification of Education (ISCED) employed in databases. The according levels of education are as follows:
    0—Pre-primary (nursery) education;
    1—Primary education, or the first stage of basic education (six-year educational period starting from ages 5–7);
    2—Lower secondary education, or the second stage of basic education;
    3—Secondary education (upper level);
    4—Post-secondary, non-tertiary education;
    5—The first stage of tertiary education, which does not lead directly to the acquisition of an academic degree (minimum duration of two years);
    6—The second stage of tertiary education, which leads directly to the acquisition of an academic degree.
13. Employment rate among those in the 25–64 age group with, at most, a lower secondary education.
14. Data for Portugal are extreme compared to the EU as a whole, with the proportion of the population with a low-level education above 70 per cent in the 25–64 age group. The reason for this is that the Salazar regime deliberately kept people in a state of illiteracy prior to the democratic transformation (Bragues 2011).
15. Ireland can claim relatively the largest number of persons holding technical or scientific qualifications among the 25 member states.

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4

Models of Capitalism in the Enlarged EU

4.1 Combined Clusters

I attempt to examine the clusters obtained in the individual subsystems collectively in order to see what kinds of clusters would emerge as a result of taking into account all the subsystems together, with the existing clusters as a basis. Because I form new clusters from cluster classifications as categories, a "two-step" cluster analysis has been applied using the SPSS software. The advantage of this process is that the cluster-formation process is able to handle categorical variables. The result is what is considered—according to the process—to be an optimal cluster number. Consequently, we obtain two clusters: one containing the OMS, and the other containing the NMS.

Given that the cluster number suggested by the software is only a recommendation,[1] it is customary to investigate other possibilities outside of the resulting "optimal" cluster number. Consequently, I try out solutions involving three, four, or more clusters. I list the clusters in the order in which they separated from the cluster of OMS as the number of clusters increased[2] and choose from among the various cluster numbers by comparing them with qualitative analyses found in the literature.

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Table 4.1 Combined clusters of the EU-25 member states

North-Western cluster	Austria, Belgium, Denmark, UK, France, Netherlands, Ireland, Germany
Mediterranean cluster	Greece, Italy, Portugal, Spain
Nordic cluster	Finland, Luxembourg, Sweden
Central and Eastern European cluster	Bulgaria, Czech Republic, Estonia, Poland, Latvia, Lithuania, Hungary, Romania, Slovakia, Slovenia

The combined clusters essentially correspond to the four models that crystallised from the old EU member states in the literature that does not follow the dual classification method (Table 2.1) and that, according to the results of this investigation, must be complemented with the CEE model (Table 4.1). In the following, we scrutinise these models, using the results obtained from analysis of the individual subsystems.

4.2 The Nordic Model as a Blueprint

In this analysis, Luxembourg is included alongside the Nordic countries of Finland and Sweden. No economic context can be attributed, given that Luxembourg formed a cluster of its own as a special case in three separate subsystems. For this reason, its customary classification in the literature among its continental neighbours might be more justified. Denmark, at the same time, is missing from the cluster of Nordic countries. Nevertheless, Denmark can be regarded as a borderline case because, in terms of both its labour market regime and social protection, it belongs firmly within the cluster of Nordic countries.

The fate of the Nordic countries attracts attention strongly disproportionate to their size; this does not apply only in Europe. One may recall that institutional analyses came to the fore partly precisely because of the debate over whether market economies are necessarily advancing in the direction of the free competition-based Anglo-Saxon model. For those who reason that there is no conformity to a universal rule, the main argument is the success of the Nordic countries. For this reason, a brief summary will be provided about the main attributes of these countries' institutional arrangements, which the literature roughly agrees upon and which also emerged from this cluster analysis.

The structural realignment that began in the 1970s, followed by intensifying competition in the global economy and the deepening of European integration—which also determined the economic environment in countries that were not yet EU members—made the system known as the Swedish or Scandinavian welfare state unsustainable beginning in the second half of the 1980s. These processes took place in different ways in the various countries. The performance of the *Swedish* economy has steadily deteriorated since the second half of the 1970s, making attempts to handle the situation not through structural reforms but via currency devaluation all in vain. The high level of employment, maintained amid a growing balance of payments deficit and public debt, inevitably gave way to an employment crisis by the beginning of the 1990s. Thanks to Soviet export opportunities, the *Finnish* economy was still living through prosperous times in the 1970s and 1980s, which plunged deeper at the beginning of the 1990s because of the loss of Soviet markets. Although *Denmark* never suffered a financial and economic crisis as serious as the aforementioned two countries did at the beginning of the 1990s, slowing growth and employment problems began to emerge in the 1980s (Kiander 2004; Andersen 2011).

In summary, at the time of economic hardship afflicting the Nordic countries at the beginning of the 1990s, it appeared that the Scandinavian welfare state failed once and for all. However, successful reforms were carried out, helping these countries embark on a path of development beginning in the mid-1990s that would once again elevate them among the world's leading economies. Although welfare expenditures were cut, they still remained higher than in other developed countries, particularly compared to the Anglo-Saxon model. In Sweden's case, Lindbom (2001) examines in detail how the characteristics of the social democratic model described by Esping-Andersen (universality, the high replacement rate in pensions and sickness benefits, and so on) remained not only on the level of spending but also in the institutional system, while the quantitative reduction in welfare expenditures did not result in a qualitative change. The high level of welfare provision and the accompanying high level of taxation continue to prove effective in maintaining a strong degree of social equality, even if not to the extent preceding the 1990s. Among other factors, the outstanding innovative performance of the economy

and a flexible labour market, combined with an active employment policy, has helped sustain the elements of the welfare system. While these distinctive features of the Nordic model are common knowledge, it is considerably less well known that competition has been fierce on the product market since the deregulation of the 1990s.[3] As shown earlier, there has been a shift in the institutional framework of the financial system away from the continental bank-based system and towards a financial market regime. Opinions are split regarding how to interpret these adjustments; some hold that the current practice of Nordic countries is no longer an independent model, but rather a transitional solution on the path towards Anglo-Saxon liberal capitalism, which they term consolidated neo-liberalism (Ryner 2002). Apparently more convincing is the argument stating that it is typical of the overall modernisation of Sweden (from the second half of the nineteenth century onwards)—as the defining, trend-setting country in the Scandinavian region—that the stable market institutions of a capitalist economy have continuously developed in parallel with institutions supporting equality and solidarity (Bergh 2011). The combination of competition-based market solutions and those guaranteeing equality of opportunity is therefore not alien to Swedish development. It is also a fact that strict monetary and fiscal policy was an essential element of the original model of the Swedish welfare state from the 1950s onwards. The monetary and fiscal loosening that began in the mid-1970s can be regarded as an "aberration" occurring in response to the crisis of the time. For this reason, Anxo and Niklasson (2006) are justified in their interpretation of the reform of the Swedish economy in the early 1990s—and the restoration of monetary and fiscal rigour—as a return to the essential elements of the original Swedish model. The 1990s saw the signing of collective agreements at the company level, rather than centralised wage bargaining. However, recentralisation began at the end of the 1990s, and the results of wage bargains in export-oriented industries paved the way for the economy as a whole. A new labour market authority was established in 2000 (the *Medlingsinstitutet*—National Mediation Office), which ensured that the manufacturing sector retained a decisive role in the evolution of wages. This also restored another characteristic feature of the Swedish welfare state whereby wage agreements promote the international competitive-

ness of Swedish exports (Anxo and Niklasson 2009; Schnyder 2012). It is true not only of Sweden but also of Finland and Denmark that the essence of the Nordic model was successfully preserved amid the transformations (Lindgren 2011; Mailand 2011). In Part III, this topic will be discussed in detail.

In the first half of the 2000s, the Nordic countries also drew attention to themselves by regularly appearing at the forefront of the Lisbon reforms, aiding the competitiveness of the EU, together with the Netherlands, Austria, and Ireland (Farkas 2008). The average pace of economic growth both between 1970 and 2006 and between 1990 and 2006 was slower than in the USA but exceeded the rate of growth in the continental countries and that of the Mediterranean countries between 1990 and 2006, similar to the English-speaking countries of Europe.

Witnessing these lasting successes, it became generally accepted by the mid-2000s that efforts towards innovation, strong competition on product markets, and flexibility on the labour market offset high public expenditures; thus, a renewed Nordic model was created (Aiginger 2008; Heipertz and Ward-Warmedinger 2008). This may mean the implementation of a model that better corresponds to the distinctive features and order of values of the European economic and social model. Not only does the oft-mentioned study by Sapir (2006) present the Nordic model as one capable of simultaneously accomplishing both economic efficiency and a high degree of social equality, but studies by other research institutes close to the EU also put forward the same interpretation (Schubert and Martens 2005). Aiginger et al. (2007) likewise draw the conclusion that while economic performance justifies both the Anglo-Saxon and Nordic models, greater social cohesion counts in favour of the Nordic model. A book about the Swedish welfare state was published under the aegis of the IMF, which acknowledges—while also recommending further reforms—that this distinctive institutional arrangement is capable of functioning (Thakur et al. 2003).[4] Labour market reform in the Nordic countries—which differs substantially among individual countries—has become a point of reference in EU reform plans, with the experiences of the Danish flexicurity system serving as a guiding thread (European Commission 2007). In the midst of the 2008 crisis, World Bank experts looked upon the model of the Nordic countries as an exception from the

general rule of slow economic growth linked to extensive government spending. In order to avoid these two phenomena acting in tandem, there is a need for professional, transparent government, an efficiently functioning institutional system and the profound confidence of society (Gill and Raiser 2012). In the history of the Nordic countries, the beginnings of this favourable accumulation of social capital reach to the time before the capitalist modernisation (Bergh 2011).

These special circumstances severely limit the adaptability of the Nordic model. It is also incontestable that the ageing of society presents a danger to the fragile balance that the Nordic countries have shaped between economic efficiency, competitiveness, and social cohesion. In the mid-2000s, the question often arose of whether the Nordic countries proceed on an enduringly sustainable course. The storms of the 2008 crisis took their toll on these nations to varying degrees; we shall return to this topic later.

4.3 A North-Western, Not Continental, Model?

The cluster analysis has generated a group of countries that comprises both the North-Western continental and English-speaking nations. What appears at first sight to be an astonishing outcome is nevertheless understandable if we recall the picture we obtain of the individual subsystems. These data demonstrate that the EU's unified internal market has attained the strongest level of integration with respect to products, with only the Mediterranean countries standing out from among the OMS. Full-blown differences exist among the non-Mediterranean OMS in the areas of labour markets, the financial system, and social protection. This confirms the earlier mentioned approach of Sapir (2006), who classifies the OMS on the basis of the labour market and social protection. Here, the Anglo-Saxon model appears only in these two areas and in the financial system and in only two out of the three areas in either the UK or Ireland. The UK displays the expected Anglo-Saxon characteristics in both its labour market and financial system. Looking at its social pro-

tection regime, Ireland appears "more Anglo-Saxon" than the UK itself, while the Irish labour market also possesses typical Anglo-Saxon features. In the combined clusters, this all falls into place in a way that does not permit us to form a clearly separate Anglo-Saxon cluster, and instead, we can view the English-speaking nations as borderline cases in the North-Western group of countries. This kind of diluted presence of the Anglo-Saxon model indirectly also means that European integration as a whole can be set against the USA as a model that, despite its internal heterogeneity, can be differentiated from the American model. This coincides with the similarly aforementioned findings of Ebbinghaus (1999).

The two English-speaking countries underwent severe ordeals in the 2008 crisis, and for this reason, it is justified to devote special attention to their situation prior to the crisis as a subgroup within the North-Western cluster.

4.3.1 Anglo-Saxon Borderline Cases: The UK and Ireland

In the decade preceding the 2008 crisis, both the UK and Ireland were among the EU's most successful countries. Even by global standards, the UK delivered outstanding performance among the developed countries, with its GDP growth rate of around 3 per cent. For its part, Ireland's growth of around 5 per cent enabled it to close in by 30 percentage points on the EU-27 average per capita GDP between 1995 and 2008 (Eurostat).[5] As mentioned in connection with the Scandinavian countries, both nations were also at the forefront on the basis of indicators intended to measure the progress of the Lisbon reforms.

In the *UK*, the processes that characterised the period following the crises of the 1970s began before those of the other European countries. The service sector provided the economy's pulling power, while a flexible labour market and high level of employment led to the spread of low-skilled, low-wage jobs and increasing social inequality. British industry was pushed into the background, and there was no "patient capital" from banks behind companies financed from the financial market. Neither shareholders' short-term attitude nor the supervising role of commercial

companies encouraged industrial concerns to develop a high-added-value production structure. The welfare system was curtailed, and the government did not even target poverty reduction as a goal. In the Thatcher era, the UK displayed the characteristics of the Anglo-Saxon model, pursuing a neoliberal policy similar to that of the USA and shaping its institutional framework in this spirit.[6]

With the Labour Party's ascent to power in 1997, significant changes took place in the welfare regime, and the British system began to more closely resemble the European system. The range of services expanded as state childcare support increased and the system adapted to the dual-earner model, while application of the means-testing principle typically remained in place. Nationwide collective agreements appeared in industrial relations, at least in the public sphere. The number of students in higher education dynamically increased. The structure of the economy remained on the development path that evolved in the preceding cycle. The service sector acquired such importance that the loss of industry's status no longer occupied economic policymakers (Rubery et al. 2009).

One of the drivers of the UK's impressive growth was the performance of the financial sector, which continued to gain strength under the Labour government. As it could be seen in the examination of this subsystem, not only financial markets—but also the banking sector—are more advanced than in the other member states. In the decade preceding the crisis, financial services expanded at a rate of around 6 per cent, double the rate of GDP growth, and the most dynamic escalation was seen in the banking sector. As a result, the banks' combined balance sheet totals easily exceeded fivefold the amount of British GDP prior to the crisis (Davies et al. 2010: 325). At the outset of the period in question, the contribution of the financial sector to GDP was less than 6 per cent, but this grew within a decade to close to 9 per cent. (By comparison, this ratio is 4 to 5 per cent in the major continental countries.)

Comparing the study by Rubery et al. (2009) to this cluster analysis with respect to the appraisal of the UK's institutional arrangement, it is clear that similar empirical results can be assessed in different ways, depending on where the emphasis lies. Rubery et al. (2009) also recognise that the British institutional arrangement under the Labour government moved closer to Europe and away from the Anglo-Saxon model repre-

sented by USA, also claiming that the changes took place while preserving the essence of the latter model. It was that the EU, particularly in the context of the non-Mediterranean OMS, functions as an effective "melting pot" on the unified internal market, although important institutional differences remain—mainly in the other subsystems. During the British presidency of the EU in 2005, Tony Blair offered the member states the UK model as the saviour of Europe. In evaluating this offer, I agree with Rubery et al. (2009) that the comparative advantages gained in the services sector—mainly in finance—across decades would be difficult to transfer to other countries, although since the 2008 crisis, this is not an attractive alternative.

Financial services in *Ireland* expanded to an even greater degree than in the UK. The contribution of financial services to GDP in Ireland between 1998 and 2008 grew from barely more than 6 per cent to over 10 per cent (Burgess 2011: 234). During the 2008 crisis, however, precisely this advanced financial sector placed a huge burden on both countries. In Ireland's case, not only did the international financial crisis have a "ripple effect", but also the success story of the country already tritely known as the "Celtic tiger" was called into question. For this reason, it is worth scrutinising in a little more detail the path of development in Ireland prior to the crisis.

As is widely known, Ireland's convergence process was built on attracting FDI, which was already the focus of Irish development policy in the 1958 Economic Development Plan. The outcome was seen as unsatisfactory because the influx of capital—mainly from USA—made limited contact with local businesses, largely bringing assembly lines or simple textile industry work to Ireland. Upon the establishment of the European Economic Community in 1973, the Industrial Development Authority was established, which consciously strived to ensure that FDI flowed into high-tech sectors. The 1980s saw the initial formation of chemical, pharmaceutical, and electronics industry clusters and the successful building of contacts between multinational and local firms. However, the economic environment as a whole was unfavourable during this period because the oil crisis of the 1970s led to a recession in Ireland as well, with multinational firms cutting investments and repatriating profits amid growing unemployment. The state financed the stimulation of the economy through

the government deficit, which led to a fiscal crisis. Following this, the Irish success story unfolded in the 1990s. Macroeconomic conditions stabilised as the country adopted a strict fiscal policy, reversing a 20-year trend. The 1992 Culliton Report brought new emphases to industrial policy, pointing out the severe dichotomy and separation between foreign and domestically owned companies. A "holistic" approach in industrial policy was recommended to the government in order to resolve this. The ensuing decade saw small domestic enterprises, which were often spin-offs from multinational firms, proliferate mainly in the software industry (Andreosso-O'Callaghan and Lenihan 2011). Parallel to the soaring of the US economy, the 1990s were characterised by GDP and GNP growth of 7 through 9 per cent. Precisely because of the substantial FDI presence, GDP exceeded GNP by 20 per cent. A more realistic reflection of the situation in the Irish economy, GNP showed 216 per cent growth by 2005 compared to the 1987 base value of 100 (Kirby 2010: 33). The government contributed to this economic performance by dynamically improving the education system. When characterising labour markets in my cluster analysis, Ireland's appeared typically Anglo-Saxon in nature. At the same time, the corporatist element is firmly present in industrial relations, and from 1987, social partners regularly entered agreements on key issues of economic and social policy. This social accord was a similarly important element of economic development. The rapid rate of growth was interrupted by the "dotcom" crisis (the bursting of the bubble on the IT market), as well as by the unfavourable global economic effects of the terrorist attack on the USA on 11 September 2001. Export-led growth was replaced by growth based on internal demand, in which the construction industry played the greatest part. Labour costs per unit of output increased as the Irish economy began to lose its international competitiveness. The 2008 global economic crisis brought slowly accumulating internal imbalances to the surface.

Opinions are divided on the assessment of the transformation in the Irish economy, even ignoring the crisis. Those still deeming this transformation an unequivocal success story to this day cite, on the one hand, the undeniable growth-generating role of FDI, and on the other hand, those instances connected largely to a specific individual sector in which spill-over effects and domestic high-tech companies also appear (for example,

Barry and Bergin 2012).[7] Andreosso-O'Callaghan and Lenihan (2006) painted a more nuanced picture before the crisis. Although the role of domestic small businesses in high-tech fields grew during the glory years of the 1990s, within the sector of small and medium-sized enterprises (SMEs), domestic firms were typically microenterprises, while medium-sized firms were foreign. The propensity to export within the SME sector grows as the size of the company increases; moreover, the drivers of the boom were large companies. Despite the existence of undeniably positive examples, the 2006 data also show that most of the turnover in sectors using high-level technologies was handled through foreign companies, and in low-tech sectors by domestic companies. Labour productivity is higher in foreign firms in every sector without exception (Andreosso-O'Callaghan and Lenihan 2011). Given that a typical feature of not only the Irish but also the European convergence model as a whole is that it builds on the involvement of foreign capital, we will return to these observations later.

4.3.2 The German Locomotive Is Running Again

With the "reallocation" of Luxembourg, the combined cluster analysis also shows the usual cluster of continental countries, Austria, Belgium, France, the Netherlands, and Germany, which are joined by the UK, Ireland, and Denmark as borderline cases. For a long time in the continental countries, the reforms of the two largest states were considered the least adequate in strengthening their competitiveness. In the midst of the 2008 crisis, analysts began to rethink their assessment of the German economy. It is worth examining the German reforms in a little more depth not only because its size makes the German economy of key importance in terms of the entire European integration process but also because we are talking about a completely different type of process from the one observed in the case of the Nordic countries or Ireland.

For *Germany*, too, the two oil crises of the 1970s brought an end to the unprecedented economic boom that followed WWII. Economic growth, however, slowed down substantially only after the second shock from 1982 onwards; this is regarded as a turning point in German economic

development. The economic upturn at the end of the decade proved to be temporary, and the 1990s showed GDP growth of approximately 1.5 per cent. The full employment of the early 1970s had given way to unemployment of over 10 per cent by the mid-1990s, and in parallel with these developments, the social insurance system became unsustainable. Added to these interrelated and mutually reinforcing problems, from 1990 onwards, a new challenge arrived in the form of German reunification. A part of the country—the eastern states ("*Länder*")—where labour productivity was one-third that of West Germany, had to be integrated with the West German economy. In the mid-1990s, transfers to the east amounted to 3 to 4 per cent of Germany's GDP. It was partly due to this that between 1989 and 1998, public debt, expressed as a percentage of GDP, grew by 22 percentage points to 63 per cent. By historical standards, it represented a huge step forward that, by the beginning of the 2000s, the per capita GDP of the eastern states had reached two-thirds of that of the western states, and labour productivity exceeded 70 per cent. However, by the middle of the 2000s, with the exception of a few urban growth centres, the convergence had ground to a halt. According to leading German economists, however, the slowing in growth and high unemployment experienced from the 1980s onwards can be traced back to structural causes that were unrelated to German reunification (Siebert 2005: 39–42), and they clearly hold the old European social model responsible for their country's economic woes (Siebert 2006, Sinn 2007). The process of correction and adaptation began in the mid-1990s, but its specific method was nevertheless influenced by the reunification process. In the opinion of certain researchers, before the reunification, in the debate about how the reforms should be carried out, there was balance between the market radicals and those who supported reforming the traditional German model. Alarmed by the shock of German reunification and its economic and social consequences, the economic and political elite clearly turned towards neoliberal solutions. First of all, for example, they quickly introduced the system of collective bargaining agreements in the eastern states, as well, but the bureaucratically interposed, rootless institutions did not function in the same way as similar, socially embedded institutions in the western part of the country. From then on, the traditional corporatist German model increasingly eroded (Lehndorff et al.

2009). It is certainly striking that an acclaimed German economist such as Horst Siebert, in the subtitle of his book on the post-war history of the German economy, refers to the abandonment of the German model: "Beyond the Social Market". What makes this even odder is that the author introduces the German social market economy, and it is clear from what follows that the passing decades saw a growing departure from the original concepts and ideals, and he could have found reference points for renewal within the original social market model. Instead, however, the author refers to the British, American, and Swiss models (Siebert 2005).

The correction process began when, in agreement with the weakened social partners, wage increases were reined in. Between 1996 and 2000, unit wage costs did not grow, while productivity increased by 2 per cent a year, which brought a strengthening of international competitiveness. It followed, by necessity, that internal demand remained lacklustre and that growth could only be driven by exports. Growth in the economy as a whole jumped before the crisis, in 2006–2007, to 3.4 and 2.7 per cent, but in 2008, it was down to 1 per cent (Sabbatini and Zollino 2010: 245, 250).

The cutback on wages did not represent an institutional change, and the German labour market was also typified by the problems prevalent in the continental countries in general, that is, status preservation, generous unemployment benefits, passive labour market policy, high taxes and social insurance contributions, and the strong employment protection. Given the results for the Nordic countries, this should have been the obvious recipe for maintaining the social market economy in Germany. However, the elements of this—easier dismissals, high taxation, and a strengthening of active labour market policy—were all disputed. In Germany, it was held that due to the strong bargaining power of workers in the "core" of the labour market, the state could implement labour-market reforms only step-by-step, beginning with atypical forms of employment (Eichhorst 2007). The Germans' reservations regarding the Nordic labour market solutions were heightened by the fact that, in the Nordic countries, the state itself attempts to provide a substantial proportion of the employment in the context of welfare services, while in Germany even today, the most important segment of the labour market is export-oriented industry; that is, well-trained workers in the private sec-

tor. Among the most developed countries, only the Netherlands, Austria, and USA have a higher employment rate for workers in the private sector than Germany, while Germany's rate is roughly the same as that in the UK (Heipertz and Ward-Warmedinger 2008: 283).

The "Hartz reforms" (named after the head of the reform committee) of the early 2000s, among other changes, permitted the conclusion of more flexible employment contracts, while reducing unemployment benefits and tightening the rules for their disbursement. As the fear of Americanised labour-market solutions meant that it was not possible to carry out comprehensive reforms, the end result was a dual labour market in which traditional (permanent and protected) employment is increasingly displaced by flexible, but unsecure, jobs. The "hybrid" system of labour market institutions that is created by such layering gives rise to instability (Eichhorst 2007). The introduction of solutions that provide incentives to work, for example, the payment of unemployment benefits for 18 months rather than 36, also represented a cut in welfare expenses. With pension reform and other cost reductions, state redistribution decreased from 48 to 43 per cent of GDP between 1999 and 2009 (Jackson and Sorge 2012: 1152).

The strengthening of competition in the global economy and the EU in 1990s brought changes to the system of corporate governance; process and product innovation were strengthened both at large corporations and in the "*Mittelstand*", the SME sector that is regarded as the strong point of the German economy. All this had an impact on labour relations and on the co-determination system. At companies, foreign ownership emerged, and the relationship with banks, with "patient capital", loosened. The financial system—in line with the financial-market liberalisation underway in the EU—shifted from being a bank-based system to a more market-oriented system. Trade union membership fell dramatically, and negotiations between social partners were decentralised from the sector level to the corporate level.

Behind these changes lies not only the pressure of competition in the global economy but also the transformation of the economic structure. Although some 90 per cent of German exports are industrial products, by the 2000s, almost 70 per cent of the employed worked in the service sector. Insurance-based unemployment benefits, dependent on status,

were created for specialised skilled workers in the industrial manufacturing sector. In the labour market, however, a growing percentage of workers have general training and skills, and a high number of these are women. The proportion of those on low wages has also increased (from 11.1 per cent in 1995 to 17.5 per cent in 2006), which is on a par with the British level (Fleckenstein et al. 2011: 17). In the more flexible labour market, supporting women in work has become a more important task than ensuring the status of those with special training, and accordingly, the focus of social services has shifted from unemployment benefits to family policy, and the formerly conservative welfare system, based on the man as breadwinner, is slowly changing.

The German reforms have also raised the question of whether what we are seeing is Americanisation, following the Anglo-Saxon path, and opinions in this regard are divided. Some highlight the survival of special characteristics (Boyer 2005b), while others consider convergence to be the defining feature (Lane 2003). Streeck sees the transformation of Germany as nothing less than a case study of the return of capitalism. Such a return "seemed impossible three decades ago" (Streeck 2009: 233). Others regard the duality of the industrial economy working with well-paid, skilled workers, and the low-wage service economy, as well as the attendant low domestic demand, the declining investment in human capital and the growing social inequality, as factors that endanger long-term development (Lehndorff et al. 2009).

Experience to date shows that in the wake of the reforms, by the mid-2000s, the competitiveness of the German economy had strengthened, and it had once again become the "engine" of European integration. The role it played in the years following the 2008 crisis will be discussed in detail later.

4.3.3 The Other Half of the European Tandem: France

The other large continental country, France, took the path of gradual reforms, similar to Germany. The end of the post-war growth period and the start of the new era came at the beginning of the 1980s for the French economy, too. France, however, arrived at this point with a completely

different system of institutions and in a far worse economic state than Germany did. The stagnating investment, double-digit inflation, burgeoning deficit, and currency crisis forced a change of economic policy from the Socialist president Mitterrand in 1983, and although long, this process led to the most dramatic institutional transformation among the OMS.

If we were to compare the French economic system in the four decades after the WWII with that of Germany, France and Germany would not fall into the same group of countries. With respect to this period, the ratings that label France as a state-led economy (for example, Schmidt 2002) are correct. The state not only closely regulated the economy and controlled macroeconomic processes through indicative planning but also was an owner of large corporations operating in what were regarded as key industries and providing public services, and even in commercial banks; consequently, it employed around a fifth of the labour force. At large corporations, the relatively low-skilled employees working in an inflexible Taylorist system were supervised by a high number of middle managers. Job protection was strong; the labour market displayed the features of the continental model. In labour relations, however, we do not find the corporatist solutions typical of Germany and other continental countries and of the Nordic countries. A relatively small part of the heterogeneous labour force (25 per cent in the early 1970s) formed a few high-membership, politicised trade unions. The culture of contractual relationships between the various groups of society, which primarily permeates the Scandinavian countries, was absent here; labour relations, and the conflicts between capital and labour, were controlled by the state. The welfare state, as in other continental and Mediterranean countries, provided comprehensive protection that was dependent on status; that is, on one's employment situation, a decisive factor in this being the situation of the head of the family, in other words, the breadwinning male (Berrebi-Hoffmann et al. 2009).

When they came into power in 1981, President Mitterrand and the Socialist government began with the traditional Keynesian policy of demand stimulation and nationalisation. However, they soon had to respond to the deepening fiscal and monetary problems with a change in economic policy. In the public sector, they carried out sweeping privatisa-

tion; the strict monetary policy, the abolition of price and capital control, and the introduction of part-time employment regimes amounted to a deep restructuring of the institutional system that had been in place since the end of the war. The government made this result politically tolerable by introducing a series of social and labour-market measures. In addition to the burden that these measures placed on the budget, the early retirement option and generous social transfers kept employment at a low level, in contrast to the Scandinavian solutions that aimed to return workers to the labour market (Levy 2011).

Measures that seemed clearly liberal at first glance, such as privatisation and deregulation, did not lead to an institutional system of the Anglo-Saxon kind. To ensure the stable management of large corporations and banks, the bulk of shares in the privatised companies were sold to a "hard core" of investors—long-term investors, including banks, insurance companies, and industrial corporations—thus circumventing the financial markets. Some 15–20 per cent of the shares came to be owned by 15–20 holdings. This process was intended to guard against future takeovers of the companies. After a while, the development of the large corporations was set back by the lack of an advanced network of suppliers with which a cost-saving, "just-in-time" supply system could be established. In France, as a part of regional policy, from the 1960s onwards, incentives were given for siting industrial companies outside the Paris agglomeration. In the 1980s, these subsidiaries were used to build up the regional supplier networks of the companies that continued to have their headquarters in Paris. With the participation of local higher education, these subsidiaries assisted in the modernisation of the SME sector. This entire process, however, was coordinated no longer by the state, but rather by the large corporations. With respect to funding, the role of the financial markets increased in comparison to the almost exclusively (state-owned) bank financing of the previous period. The state contributed to the success of the changes by developing the education system and bringing it into line with the needs of the labour market. The legislation made it possible for the institutions of worker participation to emerge at corporate level, thereby neutralising the trade unions and integrating workers into the corporation. The number of strikes decreased considerably, and in capital-labour relations, the state is now only a last

resort if agreement cannot be reached. The transformation was made easily because the French elite were selected during their university studies, at the "*grandes écoles*", and during their careers, they move between state, financial and business management posts every few years, building up a complex network (Hancké 1999; Schmidt 2003).

The reform of the French labour market began by following a similar logic to that of Germany in a series of small steps. However, France did not progress as far as Germany; in terms of competitiveness, the French economy fell behind that of Germany, and an even more dichotomised labour market was created. Atypical employment was partially liberalised. There was a shift away from passive labour market policies towards the activation of the labour supply, which they tried to achieve through reductions in benefits and stricter controls (Eichhorst 2007). Attempts were made to lower the unemployment rate, which had been permanently high since the mid-1980s, by introducing a 35-hour working week; however, not even this represented a long-term solution. The government tried to alleviate unemployment by creating jobs in public services, and despite the privatisations of the 1980s, the state remained the largest employer (employing 21–24 per cent of all workers in the mid-2000s). From the 1980s onwards, there were constant shifts in the insurance-based, employment-linked Bismarck model of the welfare state towards minimum incomes based on national solidarity and working as a social safety net (Berrebi-Hoffmann et al. 2009: 191).

The French transformation was also promoted by the obligations stemming from European integration (a European single-market programme, preparation for adopting the euro). The most successful years were between 1997 and 2001, when the growth of the French economy exceeded the EU average; these were followed by years of mixed results. After the dismantling of state dirigisme, the social services system compensating for the liberalisation reached such a level that the right-wing president Sarkozy, when taking power in 2007, believed that it was unsustainable and perpetuated high unemployment. For this reason, he announced further liberalisation, but in response to the 2008 crisis, he attempted to revive certain elements of the old French dirigisme. His experiment had no resounding impact, partly due to EU regulation and partly due to his defeat in the 2012 election.

When assessing the institutional transformation, scholars unanimously recognise that the changes were dramatic. Hancké (1999) and Levy (2011) place the emphasis on the changes, while Berrebi-Hoffmann et al. (2009) highlight the hybrid nature of the institutions that emerged in the wake of the reforms. Schmidt (2003) argues that the transformed French market economy remains a third variant of capitalism (contrary to the dual categories of the VoC model). In the cluster analysis, it became apparent—without casting doubt on the surviving unique features of the role undertaken by the state—that the French economy fits into the group of continental countries. Viewed from the level of the EU-25 nations, the similarities that tie France to these countries seem more important that the peculiarities carried over and retained from its past. Amable et al. (2012), based on their institutional analysis, also confirm that France belongs among the continental countries; the problems and instability of the French implementation of the continental model in connection with the financial crisis will be discussed later.

4.3.4 The Smaller Continental Countries

Among the three small continental countries, the literature usually praises the results of the reforms in the Netherlands and Austria, but the path taken by Belgium is more contradictory. In my cluster analysis, the Netherlands displayed features similar to those of the Nordic countries, such as its labour market apparatus and its efficient education system; together with the Nordic countries, and to a greater extent, it has shifted towards a market-oriented financial system. Austria has consistently moved with the "hard core" of continental countries, Germany and France, but in terms of the labour market, it is usually grouped, together with the Netherlands, among the reforming continental countries (Eichhorst 2007; Sapir 2006), and in terms of its education system, it has joined the cluster of frontrunners.

The *Netherlands* has traditionally been regarded as a trading nation since the sixteenth century, and even after the industrialisation of the nineteenth century, it did not have such a strong industrial base as Belgium. After WWII, until the oil crisis, the Netherlands showed dynamic economic

growth; the state, employers, and employees cooperated to reduce growth in prices and wages, thereby creating a supportive environment for investment. It was during this period, in the fields of oil refining, the chemical industry, the food industry, and the tobacco industry, that today's well-known Dutch multinational corporate giants were born. The first oil crisis brought a greater slump in the Netherlands than in the other Western European countries. The expenses and burgeoning social services that came with high unemployment were initially covered by the income from oil and natural gas fields, which had begun production in the 1960s. The strengthening of the Dutch guilder on the basis of oil and gas exports, however, had a negative impact on the exports of other sectors, in a phenomenon that has come to be known in economics parlance as the "Dutch disease". In the 1970s, wages spiralled out of control, inflation rose, and, after the second oil price explosion in 1980–1982, the Dutch economy went into a severe recession. After this, the reforms began, the results of which began to be seen in the mid-1980s. In 1982, the social partners established the Wassenaar Arrangement, under which they restored the practice of keeping wages down. Here, too, the measures intended to make the labour market more flexible began with those in fixed-term employment relationships. The spread of part-time employment was primarily related to the fact that women began to work en-masse in the 1980s (Visser and Hemerijck 1997).

In the early 1990s, the reforms gained new momentum due to the renewed slowdown in the economy. As a consequence of privatisation and liberalisation, institutional investors took on a more prominent role among the owners of corporations, and both the outflow and influx of FDI doubled. In the Netherlands, deindustrialisation took place on a larger scale than in the other continental countries and was accompanied by a parallel increase in the ratio of services to GDP. The role of Dutch banks strengthened in the global financial markets, and Amsterdam grew to become a financial hub. However, the Dutch industrial multinational corporations also retained their importance. Labour relations took a paradoxical course. While in legal terms, the corporatist negotiations became decentralised by the mid-1990s and the membership of trade unions declined considerably, the informal role of the Social and Economic Council and the so-called Labour Foundation strengthened.

The Dutch version of the flexicurity system was enshrined in the 1999 Act on Flexibility and Security, which was also accepted by the social partners. In the welfare system, the responsibility of the individual was emphasised; the pension system was placed on three pillars, comprising the citizens' pension and the insurance-based pension related to employment, and voluntary pension insurance. The transformation of the welfare system and reduction of state expenditure brought spectacular results in the second half of the 1990s in the form of an improvement in the balance of public finance. By the turn of the millennium, the Maastricht criterion relating to public debt had also been met (Houwing and Vandaele 2011).

Belgium's post-WWII upturn had already turned to recession by the end of the 1950s, a factor of which was the loss of colonial incomes from the liberated Congo; additionally, Belgium also had to take over the new state's debts. The 1960s were a "golden decade" for Belgium, too, but the new automotive and chemical industry investments went to Flanders, while in Wallonia, with its loss-making, crisis-ridden coal mining sector, the industrial decline did not stop. The oil crisis and the accompanying steel industry decline hit Belgium hard, and during the 1970s, society showed little willingness to accept the necessary austerity measures. As a result, public debt spiralled out of control, remaining above 110 per cent of GDP throughout the 1980s, despite having only been 48.1 per cent back in 1970 (Mommen 1994: 124, 214).

In Belgium, the reforms started later than in the Netherlands, and the state's spending beyond its means continued in the 1980s. In the 1990s, FDI picked up in Belgium, too, but no national champions akin to those of the Netherlands emerged. The rise in foreign investors had already weakened the Belgian business networks by the time the debate on how best to keep economic decision-making in Belgium began. The majority of Belgian corporations are family-owned; a law passed in 2007 stopped them from being squeezed out of decision-making processes in joint stock companies.[8] In labour relations, corporatist cooperation has continued unabated, the proportion of trade union members is high, and collective wage negotiations are centralised. At the same time, the state's role as an intermediary has come to the fore, and corporatism has weakened, but these results are not due to globalisation or neoliberal dominance, but

rather to the federal reorganisation of the Flemish and Walloon provinces in 1994, which was accompanied by the fragmentation of corporatist negotiations. The subdivision of the country has also left its mark on the labour market; as we have seen above, in terms of employment, there is a ten-percentage-point difference between the country's two provinces, in favour of Flanders. Although the welfare reforms, similar to those in the Netherlands, are built on greater individual responsibility, in practice, hardly any austerity measures took place, and the changes are of lesser importance than those enacted in the Netherlands (Houwing and Vandaele 2011).

In *Austria*, the post-oil crisis era brought a long series of step-by-step reforms. After WWII, the country became a textbook example of social partnership, where all strata of economic and social life were permeated by the parity system that was adhered to almost pedantically. Employer and employee advocacy groups agreed on economic and social issues in close cooperation with representatives of the Austrian People's Party and Socialist Party. Essentially, the parliament merely enshrined the decisions in law. The trade unions were strong; the Socialists were among the governing powers for 52 years between 1945 and 2008. The Austrian business sector carried less weight than in Sweden or the Netherlands. A substantial proportion of the major corporations were under state ownership; however, the presence of foreign, and especially German, investors was not negligible. "Austro-Keynesism" (a combination of the fiscal stimulation of demand and a strict monetary policy) was effective in managing the first wave of the oil crisis, but the growing losses of state corporations forced a change of direction.

Privatisation took place in several stages, beginning at the end of the 1980s and the beginning of the 1990s with the banks and industrial corporations, while the turn of public services came only after EU accession, in compliance with the common market obligations. The latter stage also affected the SME sector, while until then, the sector had been supplied with cheaper raw materials and energy by the state corporations. In the course of the privatisation, efforts were made to ensure that the headquarters of the corporations remained in Austria and to also keep the better-quality jobs there (Alfonso and Mach 2011).

In the wake of the liberalisation and deregulation carried out in the 1990s, fierce market competition emerged. Austrian companies

responded with product and process innovation, which had not previously been among their strengths. The SME sector was backed up by the economic chambers, membership to which remained compulsory. Following the eastern expansion of the EU, the expansion of Austrian companies in the NMS gave a boost to the whole economy.

Even in the 1960s and 1970s, the Austrian labour market was more segmented than in other Northern European countries. In the tourism, construction and clothing industries, many guest workers were employed in the less favourable jobs even then. The liberalisation of the labour market further reinforced this segmentation, and the proportion of those working part-time and with fixed-term contracts rose steeply from the 1990s onwards. In Austria this resulted not from the government's active deregulation, but rather from a process of spontaneous adaptation by the companies. Despite the decline in trade union density, the collective bargaining system remained, albeit in a far more decentralised form. In policymaking, however, social partners were pushed into the background, and the parliament took on a greater role. The restructuring of the welfare system also displays a process of constant adjustment. Within the classic Bismarck system, the first minor austerity measures took place as early as the end of the 1980s, but the right-wing coalition accelerated the pace of the transformation at the beginning of the 2000s, with the slashing of unemployment benefits and the tightening of the rules governing the pension system, including the abolition of early retirement. The comprehensive pension reforms of 2003 triggered the largest strike in Austria's history. In summary, Austria carried out significant changes to its system of market economy institutions while managing to maintain a high degree of continuity (Alfonso and Mach 2011; Hermann and Flecker 2009).

4.4 Mediterranean Europe

The Mediterranean countries, Greece, Italy, Portugal, and Spain, clearly make up a cluster separate from the Nordic and North-Western countries, which is a notable result because in the progression of the 2008 crisis, to date, they have also constituted a markedly separate group within the euro area. It may come as a surprise that one of the founding member

states of the union, Italy, in spite of its developed northern regions, fits seamlessly into the cluster of Mediterranean countries. There was not a single subsystem where, diverging from the other Mediterranean countries, Italy could have been placed among the continental countries.

In contrast to the success stories of previous decades, in recent years, we have heard of almost nothing but the difficulties faced by the Mediterranean countries, so it is worth taking a longer historical view to summarise just how they achieved their economic successes in the first place and what kind of structural and institutional characteristics were responsible for the failure to sustain these.

4.4.1 Convergence of the Mediterranean Countries

Italy's economic performance was one of the post-WWII "miracles", alongside those of Germany and Japan. Until the 1980s, the Italian economy displayed formidable growth (the average was 5.7 per cent in the 1960s and 3.8 per cent in the 1970s). Under the division of labour within the EU, in contrast to the North-Western countries that produced investment goods, the Italian economy specialised in the production of consumer goods. In the 1970s and 1980s, the small businesses of the North-Eastern region, concentrated in industrial zones and clusters, adapted well to the "post-Fordist" era, which demanded greater flexibility; and while retaining their traditional consumer-goods-manufacturing operations, they extended their manufacturing operations to include the machines and equipment necessary for their production. Even in the 1980s, however, they were capable only of maintaining the competitiveness of the economy as a whole by means of continuous currency devaluation. The extremely modest growth of the 1990s was followed in the 2000s by expansion of less than 1 per cent. It seems that Italy has become "bogged down" in a specialisation built on low skills, and in the high-growth, highly R&D-intensive sectors, it has been steadily losing ground in the global market since the 1990s. The flexibility advantages of the small businesses are outweighed by measures such as increased spending on R&D, information technology, and human capital, and these are mainly the preserve of medium-sized and large corporations. This sum-

mary assessment can be nuanced considerably by taking the country's seemingly hopeless North-South divide into consideration. In the northern part of the country, an internationally competitive corporate sector can be found, while the southern part is increasingly falling behind. In 2007, in the two northern regions, per-capita GDP was 124–126 per cent of the EU-27 average, while in the southern region, it was 69 per cent (European Commission 2010b). In the decades of dynamic growth, the central government pumped considerable resources into the lagging southern regions, with scant results. The high hopes attached both to the funding sources themselves and to the expected results ran out, and since the 1990s, the disparity between the two halves of the country has been growing again. This can be effectively illustrated with a single item of data: in 1997, there was a ten-percentage-point difference in the employment rate between the northern and southern regions, while in 2003, this figure was 20 percentage points (Simonazzi et al. 2009: 214).

The EU accession of *Spain* and *Portugal* ended a long period of isolation; after the dictatorships of Franco and Salazar, it was fundamentally in Europe's best interest to strengthen democracy in the Iberian Peninsula. Although as a founding member of the European Free Trade Association, Portugal was theoretically a more open economy, the Franco regime left a more favourable economic legacy. The Portuguese economy had also been stressed by the pre-1974 colonial wars. The second wave of the oil crisis caused a severe economic slump, and the return to democracy—which entailed a strengthening of wage demands—led to an expansive fiscal policy. It was against this uncertain backdrop that the countries joined the EU in 1986, when per-capita GDP was 72.5 per cent of the EU-15 average in Spain and 52 per cent in Portugal. Concerning the Iberian countries, it is difficult to overstate the stabilising role of the institutional system adopted as a result of community membership. Economic growth was assisted not only by the joining of the internal market but also by the assistance received under EU cohesion policy. For example, between 1994 and 1999, EU assistance amounted to 1.5 per cent of Spanish GDP and 3.3 per cent of Portuguese GDP.[9] Membership in the EU enjoyed enthusiastic public support, and by 2000, Spain's per-capita GDP had grown to 81 per cent, and Portugal's to 74 per cent of the EU-15 average. Until the end of the 1990s, Portugal's growth was more dynamic, at an

average of 2.5 per cent per year, while Spain's economy grew at a rate of 2.1 per cent. Around the turn of the millennium, the situation reversed; Spanish convergence sped up, the approximately 20 per cent unemployment rate fell to 8 per cent before the 2008 crisis, while 5 million (mainly Spanish-speaking Latin Americans) immigrants joined the labour force among an ageing population. By 2006, Spain's per-capita GDP not only exceeded the EU-27 average but also approached the EU-15 average (at 98 per cent thereof). It was also during this period that Spanish growth came to be overshadowed by the fact that the sectors driving it were the construction industry, commerce, financial services, and catering, which do not participate in foreign trade and have a low R&D content (Royo 2008: 36, 68; 2010: 223).

In Portugal, following its entry to the euro area, fiscal discipline relaxed, and the balance of payments deficit was also high. The budgetary consolidation attempts did not yield permanent results because rather than being based on structural reforms, they were based on increasing revenue. Economic growth slowed; indeed, there was actually contraction in 2003 (–0.8 per cent), the convergence changed to divergence, and per-capita GDP in 2006 was only 70 per cent of the EU-15 average (Royo 2010: 233).

Greece at the end of the WWII was clearly an agricultural country, and it began to be industrialised from the 1960s onwards, which is also when international tourism began. In the wake of the civil war that broke out after the world war, the country remained deeply politically divided, reaching the point where, when a weakening of the right wing was expected at the next elections, it was used as a pretext for a military junta to take over the government in 1967, lasting for seven years. During this politically turbulent period, economic growth exceeded 8 per cent per year, but this was not accompanied by job creation. The economy was incapable of absorbing the labour capacities freed up from agriculture, and the surplus labour force was removed through an active emigration policy. (One-third of those in the 15–44 age group left Greece during this period.) Then, from the mid-1970s until the mid-1990s, the Greek economy went into a state of near stagnation, with growth of barely over 1 per cent. In addition to the recessive impact of the oil crisis, heightened welfare expectations related to democracy also played a role. The wage

increases were detrimental to investments, and state spending led to a double-digit budget deficit. Additionally, after the fall of the dictatorship, the government embarked on a massive nationalisation programme, and in this respect, Greece caught up with Italy and Portugal. The industrial crisis of the 1980s primarily impacted large and medium-sized corporations, and, as in Italy, the response was to reduce the size of companies. In the textile and food industries, a network of small enterprises working as subcontractors emerged. For small businesses, the employment of unpaid family members and informal working arrangements became a widespread means of cost-cutting. The labour market disparities deepened between the state employees engaged in favourable terms, which increased greatly in number due to the unemployment resulting from the crisis and the mainly informal workers in the small businesses. In the 1990s, first, as a result of the single market program of the EU and then the Maastricht Treaty, some deregulation and privatisation took place in the Greek economy, too. All these factors, however, did little to change the fact that the Greek state was captured by interest groups, showed weak governmental performance, and was exceptionally corrupt by European standards. Despite the weak system of market institutions, the economy managed to display 3 to 4 per cent growth in the decade before the crisis. This result can be explained by the fact that capital market liberalisation and product market deregulation were carried out within such a rigid system that even this small change stimulated growth. Contributing factors were the 2004 Olympic Games and the impact of support from the EU (Mitsopoulos and Pelagidis 2011b: 111–113). The price of this growth, built on the shaky foundations of the constant increase in the balance of payments deficit and public debt, was paid by the Greeks in the 2008 crisis.

4.4.2 Changes in the Institutional System

Notwithstanding the different historical paths, on the basis of our cluster analysis and the case studies of the individual countries (Banyuls et al. 2009; Bragues 2011; Della Sala 2004; Karamessini 2009; Kornelakis 2011; Royo 2008; Simonazzi et al. 2009), in terms of their institutional

arrangement and the methods of their transformation, there are striking similarities to be found between the Mediterranean countries.

In Italy, the North-South divide, and in the three other countries, the legacy of the authoritarian and/or outright dictatorial systems, left their mark on the system of market economy institutions and, to this day, remain an obstacle to the adoption of solutions that have proven successful in the North-Western countries.

The ownership structure of the large corporations is concentrated, and they are mainly family-owned. The SME sector is extensive and lags far behind the large corporate sector in terms of its efficiency and innovation capacity. The size of the informal, shadow economy is also considerable, and since the 1990s, the majority of immigrants have found work in this sector. The informal sector reduces the tax base, which, in turn, limits the state's scope for manoeuvring in regard to managing social problems.

The state sector had a substantial role in the decades following WWII. In the 1990s, privatisations were carried out (which, with the exception of Greece, took place on a very large scale), but without the appropriate competitive environment, the expected improvement in efficiency failed to materialise.

Even in countries where the post-oil-crisis stagnation was followed by economic growth in the 1990s (Spain and Greece), this effect was achieved only at the cost of external and/or internal imbalance. All of the Mediterranean countries struggle with labour efficiency problems; Portugal and Greece have remained at a low level with some improvement, while Spain, and to an even greater extent, Italy, have clearly diverged from the EU-15 average. The annual average change in productivity during the pre-crisis years of the 2000s was negative in all four of the Mediterranean countries (Eurostat). Given the low level of R&D spending and the weak innovation performance, the modest improvement or actual deterioration in labour productivity comes as no surprise. The emergence of competitors both within the EU (the NMS) and from outside the EU (China, India, and other emerging countries) led to market loss. In the period after the oil crisis, from the 1980s until the precursor of monetary union, every Mediterranean country tried to maintain competitiveness by means of currency devaluation.

In the education system, huge growth in enrolment took place in comparison to the past in these countries, but by European standards, they came at the bottom of the league table in terms of the quality of the education system, as well as in their implementation of the Lisbon reforms (Table A.7).

In the decades following WWII, the labour market, similar to the product market, operated inflexibly, with strict state regulation in every country. The liberalisation process began in the 1980s, but assertive reforms took place only from the 1990s onwards. They followed the same logic as in the continental countries; in other words, the unionised industrial workers managed to at least partially retain their position under labour law, which is why the fixed-term or part-time employment contracts, the reduced labour-law obligations, were introduced in the lower-paid, less skilled sectors, especially the service sector. This opportunity also arose from the fact that the labour market had always been segmented, as workers in small businesses had never been unionised, not even in the heyday of the trade unions. The reforms that began from the "margins" made for an even more segmented labour market than in the continental countries.

Labour relations during the times of the dictatorships were defined by the lack of free trade unions; either they could not operate legally (Spain) or could perform their activities only with statist corporatist frameworks (Greece, Portugal). Following the transition to democracy, in these three states, as well as in Italy, the trade unions displayed a class-warrior mentality even when agreements were reached in spite of the conflicts (for example, in Italy, the moderation of wage increases in second half of the 1980s, and in Spain, the 1977 Moncloa Pact). The ferocity of the conflicts abated with the decline in unionisation and in response to the EU-wide acceptance of the ideal of social partnership.

Welfare systems everywhere were typified by a strong reliance on the family; instead of universal care, they provided residual, fragmented services; the institutions of care for children and the elderly were undeveloped. The most important component of the welfare system is the pension system, which served to protect employment status, that is, the place occupied in the social hierarchy during retirement years. There were greater or lesser shifts everywhere towards adapting the social policy to

a dual-income model, as opposed to the family model based on a single (male) breadwinner. When women gained opportunities to work in the 1990s, they were in a far less favourable situation compared to female workers in the northern countries. State redistribution was reduced in the name of liberalisation; therefore, fewer funds were available for the development of child and elderly care institutions. In the ageing societies, a paring down of the pension system was unavoidable. Spain went the furthest in establishing a low-level, universal system (that is, one that was no longer tied to employment status).

The Mediterranean countries did not respond to the global economic transformation of the 1980s with as comprehensive reforms as those in the northern countries. Their path-dependent and incremental reforms are more reminiscent of those of the large continental countries but shaped their economies to a far less extent than in the continental countries and often created inefficient hybrid solutions. They failed to show a breakthrough in precisely the areas that are critical from the perspective of sustained growth, so it is hardly surprising that researchers of the Mediterranean countries talk about feeble, "mimed" reforms, although there are significant differences in the degree of these reforms between countries.

4.5 The North-South Divide Among Old Member States

In the institutional comparison, there is no way of arriving at an indisputable, exclusively valid classification or clustering. Depending on the aim of the research, it must be decided what level of clustering will yield an answer to our questions. In this case, I want to group, and create models of, the market economies of the EU member states in accordance with how I can interpret the differences in their economic performance. The above cluster analysis clearly revealed that in the OMS, there are far-reaching differences between the institutional systems of the Mediterranean and non-Mediterranean member states. The signifi-

cance of this was painfully corroborated by the 2008 crisis, in which the Mediterranean countries became a disaster area.

The boundaries between the non-Mediterranean countries are not so clearly defined, as well illustrated by the borderline situation of the Anglo-Saxon countries. Given the differences between the Anglo-Saxon and continental countries, it is debatable whether there is any justification for lumping them together with the group of "North-Western" countries. The differences between the Anglo-Saxon and continental countries are not the only ones up for debate, as it could be argued that despite various changes, France has retained more of the state's economic role than other continental countries. In my assessment, for the purpose of this study, the similarities nevertheless justify that the North-Western countries are interpreted a group. This grouping shows two important factors that would otherwise be missed. First, that European integration, the operation of the internal market and community policies, compel these countries to employ similar institutional solutions. These solutions aim to achieve the same as the reforms of the Nordic countries; that is, to adapt to the challenges of European and global competition while retaining as many social achievements as possible. Second, this is not just a "one-way street" involving the cutting of European welfare services and a drifting towards the Anglo-Saxon institutional system and, effectively, that of the USA. We can see in the British example that when it came to welfare services and labour relations, the Labour Party government was prepared to shift towards the Nordic and North-Western solutions.

It is clear that the longest journey has been made by the countries farthest from the institutional system that came to be sustainable in the post-oil-crisis world. These include the French or Austrian economies, which operate with considerable state ownership, but Sweden, with its massive income redistribution, and Finland, which manufactured for the Soviet market, also carried out large-scale reforms. Overall, France that departed the most from its own original institutional system that had emerged after the WWII. Although there are still some peculiarities in terms of the state's role, currently, there is certainly no justification for classifying it in the same group as the Italian or Spanish economy, which, in the 1980s, could have still have been a defendable stance.

Regarding the countries that previously served as a model in a certain sense, it is interesting to note that they have different attitudes towards the changes. In Britain, after the neoliberal shift of the 1980s, the Labour Party's correction to the "Anglo-Saxon free market model" in the 1990s took place in a way that ensured continuity. Following the failures of the 1980s, many theoreticians of the Swedish welfare state (for example, Rudolf Meidner) wrote essays about the downfall of this model. However, after one-and-a-half to two decades of successful growth, they—often the same authors—now take the view that with their reforms of the 1990s, building on the most defining traditions of Swedish historical development, agreement between the social groups, and on contractual relationships, they have returned to their own roots, that is, to the original model (Schnyder 2012). Most predominantly in Austria, through a model of "social partnership", the reform process was based on small steps. Retaining certain elements of social partnership, without any major change in ideological direction, Austria developed an internationally competitive, innovative economy from an economy built on state ownership and control and on natural resources. In terms of the ideology of economic policy, Germany departed the most radically from its past; as we saw earlier on, where this country's reforms are concerned, even in the obvious cases, no references are made to a return to the original "social market economy" model. Of course, we cannot rule out the possibility that, over time, if they were to again achieve sustained successes, the reform process would come to be interpreted as a return to their own model. The first signs of such efforts are observed (see Funk 2015).

If we compare this situation with the rate at which the Nordic and North-Western countries resolved to carry out reforms and the external forces that compelled them to do so, it is difficult to find any general inevitabilities. The larger internal markets in larger states provide more opportunities for delay, which Germany—for example—seized; however, Britain was at the forefront of a sharp change of direction back in the early 1980s. France was forced by severe imbalances to make a few drastic changes, but beginning in the mid-1980s, a continuous stream of relatively small changes had already become the norm. For the small and open economies of Sweden and Finland, it took a full-on financial crisis to set the reforms in motion. Denmark, the Netherlands, and Austria

did not wait for the situation to deteriorate, but the latter spun out the reform measures over a longer period.

While the Nordic and North-Western countries witnessed an institutional convergence with the retention of numerous peculiarities, the hybrid solutions of the Mediterranean countries did not constitute a system that was capable of producing sustained, substantiated growth. The favourable global economic environment that the region experienced for a decade and a half beginning in the 1990s and the initial cheap funding opportunities that accompanied the introduction of the euro obscured the deeper institutional and structural problems that were glaringly exposed by the crisis of 2008.

4.6 The Post-Socialist Countries

The post-socialist countries in my cluster analysis were clearly distinct from the other member states, but at the same time—as we have seen—numerous studies attempted to place these countries into existing market models or to create clusters within the post-socialist countries. In my opinion, there is clear empirical evidence that the post-socialist countries do not fit into the models that were developed for the OMS. Within the region, the differences between the countries have significance depending on the purpose of our analysis. If we seek an answer to whether the institutional systems of the post-socialist countries have common unique features that differentiate them from that of the OMS and whether this is significant with regard to their development prospects and to the European integration of the region, it is sufficient to focus on their common characteristics. If we also aim to determine whether there are opportunities for differing paths of development within the group of countries, we should also examine the differences between them. The 2008 crisis demonstrated the importance of both dimensions; the FDI-based model of reform made the region as a whole particularly vulnerable, but at the same time, the differing depths of the crisis also highlighted the importance of the differences between the countries. Therefore, both approaches will be addressed.

4.6.1 The Central and Eastern European Model

The cluster analysis therefore indicates very assertively that the separation of the CEE countries from the OMS is more pronounced than their differences, and on this basis, a CEE model of the market economy can be drawn. If we compare the individual institutional areas with those of the most similar old member state model, the peculiarities of the model can be seen more clearly.

In the product markets in the post-socialist countries, the carrier of advanced technological standards is FDI. At the same time, these markets fall into one of two groups depending on whether their functioning is characterised by moderate or more formidable bureaucratic obstacles, that is, a low or moderate state presence. Their clusters are positioned between the North-Western and Mediterranean clusters, with product markets that are less flexible than the former and more flexible than the latter. In regard to R&D&I, the post-socialist countries make up a group with the Mediterranean countries. The bank-based financial system does fit in with the model of the continental countries (in this respect, the financial system of the Mediterranean countries can be described as being comparable with the continental model), but at a significantly less advanced level.

A comparison of the labour market and labour relations presents a more complex picture than we have seen so far. The labour market lacks the duality that is typical of the Mediterranean and continental countries; this makes these countries akin to the Anglo-Saxon countries, but the labour markets of the latter group are less flexible. In labour relations, also, the similarity is half-and-half because, similar to the Mediterranean model, the state intervenes in labour relations, but in collective bargaining arrangements, the employer-employee relationship is not one of conflict. Only Slovenia made it into the group of continental countries.

In terms of the degree of social protection, the countries split into two groups. Poland, Hungary, and Slovenia fit in with the continental countries, as a "more modest version" of them. In the other seven post-socialist countries, the level of welfare spending is low, and—with the exception of the Czech Republic and Slovakia—income disparities are high, showing the traits of a residual welfare state. For this reason, they display similarity

with the Anglo-Saxon model, but in terms of the structure of financing, they have remained with the continental traditions of social insurance.

The extensiveness of the education system is on a par with the EU average, but the level of employment is worse, especially with regard to the employment of those with low qualifications. In the education system, there are no clear models, such as those in the other subsystems, but the NMS show the most similarities with the education systems of the continental countries. Only Slovenia made it into the group of—mainly Nordic—countries that present the most successful education systems.

Overall, therefore, the institutional system of the market economies of the EU post-socialist countries has the most in common with the institutional system of the continental countries, but not to the extent of enabling these groups to be identifiable. In the labour and social system, we find Anglo-Saxon elements, but we found no likenesses with any of the institutions of the Nordic countries. At first glance, it may seem that the institutional solutions of the various subsystems were combined with each other in an arbitrary manner, and the use of the term "cocktail capitalism" coined by Cernat (2006) could be warranted. However, based on a closer examination of the elements of the CEE model, in my view, they can essentially be attributed to three factors: a shortage of capital and management skills, a weak civil society, and the impacts of the EU and international organisations on the NMS. The shortage of capital and management skills made foreign investment a necessity, accompanied by immediate liberalisation, without even a suggestion of the industrial protection measures customary in emerging countries at other times and in other regions. This result came from the economic paradigm prevailing in the western countries and the level of integration achieved by the OMS. The shortage of capital made it a necessity for the financial system to be bank-based because a substantial part of the FDI was realised in the financial sector, that is, in banks. The functioning of the labour market and labour relations are different from those of the OMS because civil society, specifically unionisation, is less effectual in CEE countries than in the OMS. Without the compulsion of EU legal harmonisation, the position of employees would presumably be even weaker. A low or relatively high level of social protection, the suppression of welfare redistribution, correlates well among the NMS with the relative strength or weakness of

civil society and the depth of the roots and traditions of the institutions of social protection. The system of R&D&I is also easy to understand, given the lack of a domestically based, internationally competitive corporate sector, which drives the innovation system in the Nordic, North-Western countries. Nowhere can state-induced R&D compensate for this lack. If my reasoning is correct—in other words, if the CEE model did not emerge arbitrarily as a form of "cocktail capitalism", but as a response given to the starting conditions—it cannot be regarded as a transitional state that will automatically progress towards some other European capitalism model, and one could surmise that this institutional arrangement might be capable of reproducing itself. This possibility, however, would strongly limit the chances of convergence for the countries of the region, as it would entail the perpetuation of the asymmetric state of dependence on the economies of the OMS.

The complementarity between the elements of the institutional arrangement described in the foregoing certainly suggests the likelihood of the model's sustainability. The capital flowing into less developed countries seeks out relatively cheap, but suitably skilled labour, and this attraction can be retained with a liberalised labour market. The survival of the liberalised labour market is assisted by weak unionisation, but the former also limits the strengthening of trade unions. The lower productivity resulting from the underdeveloped domestic economy and the lower added value of the production conducted at foreign corporations permit a relatively low level of investment in human capital both in education and in the social services. This result, however, not only makes the residual welfare state durable but also limits the development of R&D&I systems, which, in turn, maintains the asymmetric dependence on the OMS and the highly developed countries in general. This type of institutional complementarity can be dismantled if the FDI can fulfil the role that economists expected of it at the time of the change in the political system, in other words, if the spillover effect enables the domestic economy to converge with that of the highly developed countries in terms of productivity.

Further research is needed in order to judge whether the survival or the transformation of the model is more likely. Therefore, the differences within the CEE model need to be addressed, that is, the capitalist transition of the individual countries. The most similar subgroup of countries is

that of the Baltic States. We also found numerous common traits among the Visegrád nations. Although Slovenia differs from these countries in many ways, it still has more in common with them than with the other Southeast European countries, Romania and Bulgaria. Due to its unique and different path, this topic will be discussed in a separate subsection.

4.6.2 The Baltic States

The population of the Baltic states is currently less than 7 million, but owing to their radical departure from their Soviet past, their geopolitical importance and their rapid convergence in the pre-crisis period, their progress is nevertheless a focus of international attention.

Estonia is the smallest of the three, but this state, which had a population of one and a half million at the time, played the pioneering role within the region. The towns of Estonia were under German influence until the sixteenth century through the Teutonic Knights and the Hanseatic League. This Finno-Ugrian ethnic group remained culturally Germanic until the second half of the nineteenth century, in spite of a century of Swedish rule followed by two centuries of Tsarist Russian rule. The Estonian national movement that arose in the second half of the nineteenth century achieved its goal after the First World War (WWI); the Bolsheviks were unable to hold on to power and were expelled by the German army at the end of the WWI, and Estonia existed as an independent nation state between 1918 and 1939. Following the Molotov-Ribbentrop pact, however, Estonia came under Soviet rule until the collapse of the Soviet Union. Without an understanding of the country's turbulent past, it is impossible to understand the choices made by Estonia—and the other two Baltic states—whereby they developed their new market economy institutions. At the time of the fall of communism, Estonia was the most westernised among these countries: before the Soviet occupation, many Estonians had emigrated to Sweden, Finland, and North America; they could understand the broadcasts of the Finnish television and radio due to their shared linguistic roots, and the Estonians were the most open to the market economy. Even within the Soviet Union, Estonia was regarded as an experimental laboratory for reforms

from the 1960s onwards, but these decades brought great setbacks in terms of development. Its industrialisation took place before the Soviet occupation, and by approximately 1940, its per-capita GDP was on a par with that of Finland; in 1990, however, it amounted to only 40 per cent of Finnish GDP. At the same time, emigration to the west, deportations to Siberia and immigration from the Slavic regions of the Soviet Union dramatically upset the ethnic composition of this small nation, and by 1989, only 61 per cent of the population remained Estonian (compared to 94 per cent in 1945) (Mygind 1997: 19–21).

The goal of creating the nation state shaped not only the political system but also the economic system. The most sensitive issue of the political transformation was the restriction of citizenship for the Russian minority. There were moves to also restrict the citizenship, and thereby the right to vote, of those who had been, or whose forebears had been, Estonian citizens prior to 1938. Following international protests, the act on citizenship was relaxed, but to this day, it prescribes knowledge of the Estonian language. Currently, the number of those without citizenship and those opting for Russian citizenship is below 10 per cent.[10]

In the Estonian privatisation, a role was given to cash and voucher-based privatisation, as well as restitution, with the latter especially prevalent in the agricultural sector. The whole process was geared toward ensuring that ownership rights were transferred from the Soviet Union to Estonia. For this reason, cash privatisation only picked up pace when the Estonian kroon was introduced in 1992 and the fear that the use of the rouble would lead to the acquisition of assets by parties from other regions of the former Soviet Union subsided. The preferential purchase options available to employees and management also served to keep assets under domestic ownership. The rules for the distribution of the vouchers were elaborated in such a way as to put the minority at a disadvantage (Mygind 1997).

In terms of the stabilisation and liberalisation of the economy, Estonia became a model country for neoliberal economic policy. Foreign trade was rapidly liberalised, and a strict wage policy was pursued. Prices shot up after the liberalisation; once Russian raw materials were priced in line with global market levels, hyperinflation broke out, but it was reined in fairly quickly with a strict monetary policy. The Estonian central bank

functioned as a currency board, and the new currency was pegged to the German mark. Because credit creation was strictly tied to central bank reserves, the central bank was unable to influence the credit growth, could not carry out open market operations, and could not finance the government deficit. In the name of neoliberal policy, welfare benefits were cut drastically, especially pensions. Spending on education and higher education, which were important for building the nation state, however, was generous. The weak employees' and employers' associations did not influence state economic policy. This economic policy brought spectacular results in terms of stabilising the economy, on the one hand, and had an impact on the structure of the economy and the development of the institutional system on the other. The rapid liberalisation sealed the fate of the industrial corporations that manufactured for the Soviet market, and apart from the flat tax, there were no investment incentives for FDI such as those offered in the Visegrád countries. Consequently, the bulk of FDI—especially from nearby Sweden and Finland—flowed into the banking sector, services and real estate sector, and a process of vigorous deindustrialisation took place. The Estonian leadership presumably allowed this to happen not only because of the consistent neoliberal economic policy but also because the majority of the industrial labour force belonged to the Russian minority (Bohle and Greskovits 2012).

In summary, Estonia embarked on a period of dynamic growth, producing a growth rate of 6–11 per cent with the exception of one year between 1995 and 2007. Following the Russian crisis of 1998, until the crisis of 2008, per-capita GDP at purchasing power parity (PPP) came 20 percentage points closer to the EU-27 average. The external imbalance, that is, the balance of payments deficit, continued to grow, however, which led to a severe setback in the midst of the global economic crisis, but I shall return to an analysis of this topic later. One of the successes in terms of development was that, as a result of the 2001 research and development strategy,[11] by 2011, Estonia had joined Slovenia in the group of innovation followers, displaying performance close to the EU-27 average (European Commission 2012). Despite the difficulties of the crisis, the Estonian economy was able to adopt the euro in 2011. The downside of the development was that all these processes were accompanied by massive growth in economic inequalities. I will examine the

longer-term social and economic impacts of these processes during the analysis of the crisis years.

Latvia's history is largely similar to that of Estonia, with the difference that there was a brief interlude between the periods of German and Swedish influence, in the second half of the sixteenth century, when it was under Polish rule. The German occupation during WWI was followed by independent statehood between the two world wars for Latvia, which lasted until 1939. After the Soviet occupation, the country was able to return to being an independent state in 1991. The ethnic composition had changed dramatically due to emigration, deportations and the Russian influx. In 1989, some 52 per cent of the population of approximately two and a half million was Latvian (compared to 83 per cent in 1945). The unusual, Baltic-derived Latvian language was not conducive to a more active relationship with the western world, as was the case with the Estonians, and the market economy was a less familiar setup at the beginning of the change in political system. In the 1930s, incomes were on a par with those of the Estonians; alongside the industrialisation process, Riga also played an important role as a centre of commerce (Mygind 1997: 19–21).

In Latvia, too, the construction of a nation state was the main objective during the change of the political system; however, Latvia had more barriers to overcome than Estonia. Latvia, and especially Riga, was a Russian military base, and the Russians had a stronger position in Latvia's industrial corporations than in those in Estonia. A strong Russian party was formed, so the exclusion of this ethnic group from citizenship was not sustainable after 1994, which was also partly due to vociferous international protests. Nevertheless, the tensions have remained to this day. In February 2012, a referendum was held on whether Russian should be an official language because 27 per cent of the population spoke Russian as their native tongue (and the proportion of those without citizenship remains above 10 per cent). Three-quarters of voters rejected this proposal.[12]

The Latvians also attempted to assert national criteria in the privatisation process, but deeper political divisions than those in Estonia led to more chaotic processes. The privatisation ran its course the most quickly in the agricultural sector, where it took the form of restitution because in

the rural areas—similar to Estonia—the majority of the population were indigenous. Voucher privatisation was intended to have a more prominent role because it could be more easily controlled in line with Latvian interests; however, in reality, this measure could be enforced only in the smaller companies. By the time that large corporations were addressed, the company managers had acquired the most valuable corporate assets through lease agreements that included a purchase option. FDI had a less prominent role in Latvia than in Estonia (Mygind 1997).

The same elements of the neoliberal economic policy are found as in the case of Estonia, only implemented with less consistency. The lowest point of the recession exceeded that of Estonia by 20.7 percentage points, and in 1992, the economic downturn was 34.9 per cent (EBRD 1999: 73). Strict wage controls, liberalisation of the labour market, and weakness of the trade unions were also observed in Estonia. Foreign trade was liberalised gradually. The political conflicts also had an impact on stabilisation policy; following the upsurge in inflation in 1992 (the increase in Russian raw materials prices), fiscal policy was strengthened under pressure from the IMF. Monetary policy played a greater role in the stabilisation process. In Latvia, first, the Latvian rublis was introduced, to be replaced in 1993 by the lat. Here, instead of a currency board, a central bank with full powers was established, but in terms of their actual functioning, there was little difference; the exchange rate of the lat was pegged first to the SDR basket and, then, later to the euro. The openness of the economy and the strict monetary policy with its attendant lending restrictions triggered a process of deindustrialisation in Latvia as well. The social system was reformed with a similar approach and social consequences as those in Estonia, and this was the first of the post-socialist countries to introduce a multi-pillared pension system (Mygind 1997).

Latvia's transformation did not lead to the same success as that of Estonia. Latvia tried to forge an advantage by providing offshore banking and commercial services to Russia through its free ports and special economic zones (Sommers and Bērziņš 2011). The growth rate and extent of convergence was similar to that of Estonia until the crisis, but in terms of its R&D&I performance, Latvia came last among the EU states, a situation that had not changed by 2011 (European Commission 2012).

Lithuania, in contrast to the other two Baltic states, existed as an independent state as early as in the thirteenth century. In the fourteenth century, the marriage of the Grand Duke Jogaila and the Polish queen Jadwiga of the House of Anjou (the daughter of King Louis I of Hungary) gave rise not only to the Jagiellonian dynasty but also to a personal union with Poland. Except for a brief period in the fifteenth century, the Polish-Lithuanian union functioned until Poland's partition in the eighteenth century. After this, Lithuania came under Russian rule and remained so until Russia's defeat in WWI. Between 1918 and 1939, Lithuania also enjoyed the freedom that it would regain only in 1991 after the fall of the Soviet Union. Before WWII, Lithuania was an agrarian nation and poorer than the other two Baltic states; its industrialisation did not take place until the Soviet era. At the time of the change in the political system, Lithuania was the least open of the three Baltic states to a market-economy approach, and its unique Baltic language, which is also different from Latvian, did not promote liaison with the western world, either. In 1989, some 79 per cent of the population of 3.5 million was Lithuanian, but this represented only a one-percentage-point decrease in comparison to 1945 (Mygind 1997: 19–21). In 1990, Lithuania made the most assertive declaration of independence, to which the Soviet leadership responded with an economic blockade. In 1991, Soviet troops carried out a military intervention, during which 13 civilians were killed at the radio and television centre in Vilnius.

For Lithuania, the Russian minority, by dint of its proportion, did not represent such a great problem as the other two countries, and the citizenship act also accommodated minorities. The Lithuanian communists were pro-independence, and the 1993 elections brought victory for the left. These circumstances led to slightly different scenarios in terms of both the privatisation and the stabilisation process than in the other two Baltic states. In the absence of nationality problems, privatisation ran its course quickly, mainly taking the form of voucher-based and employee ownership schemes; in the agricultural sector, restitution was applied here, too. The members of the old nomenclature acquired corporations by taking out bank loans to buy vouchers from investment funds, which had obtained them from the general public. The collateral for these loans was the inventory stock of the companies—under their management—

that they planned to purchase (Samonis 1995). Initially, foreigners could acquire only a 99-year lease. The stabilisation process—again, in the absence of nationalist pressure—took place more slowly; here, too, the recession was its greatest in 1992, at 21.3 per cent (EBRD 1999: 73).[13] The reduction of real wages took place later than in the other two countries, under pressure from the IMF. Fiscal and monetary policy was tightened from 1993 onwards, successfully curbing hyperinflation (Mygind 1997). The country adopted its own currency, the litas, and after lengthy disputes, the Lithuanian central bank also functioned with the powers of a currency board. The flat tax was also a feature of the Lithuanian transformation, as was pension reform, although private pension fund membership was not made compulsory. While in Lithuania, there was no determined neoliberal policy as in the other two Baltic states, the impoverishment of the old and the rapid growth in social inequalities occurred, and the trade unions also played no greater role than in the other two Baltic states (Bohle and Greskovits 2012).

Lithuania's performance in terms of convergence falls between that of Estonia and that of Latvia, but it is closer to the latter. The extent of deindustrialisation did not match that of the other two countries, but Lithuania's R&D&I performance was sufficient for it to overtake only the Latvians and the Bulgarians (European Commission 2012).

4.6.3 The Visegrád Countries

In the first half of the 1990s, besides the Baltic countries, *Poland's* rapid transition attracted the greatest interest and recognition. At that time, the start of the radical transformation and rapid growth of Estonia and Poland were the focus of international attention as a vindication of the neoliberal recipe, which was followed at the beginning of the 2000s by that of Slovakia, the "Tatra Tiger", for similar reasons. The performance of the Polish economy during the 2008 crisis garnered more interest, and there was talk of a growth miracle (Lehmann 2012).

Poland suffered major losses, even in comparison to the other socialist countries, during the change in the political system. For example, per-capita GDP in PPP matched that of Hungary in 1950, but by 1989,

Hungarian GDP was 146 per cent of Poland's. After WWII, Poland's GDP had exceeded that of Greece, Spain, and Portugal; by the time of the change in the political system, these countries' GDP was twice to two and a half times Poland's. The rate at which the Polish economy fell behind accelerated in the 1980s; between 1979 and 1982, output fell by 25 per cent due not only to the typical problems of socialist economies but also to the 1981 imposition of martial law and the isolation from the west that ensued (Rapacki 2008: 21–22).

The strengthening political opposition was not broken by martial law, and the attempts at economic reform also failed to yield results. Poland arrived at the change in the political system with a massive public debt, constantly on the verge of state bankruptcy and, in 1989, hyperinflation. This situation forced the first freely elected government to embark on a comprehensive stabilisation program; there was no real choice between "shock therapy" and a gradual transition. The stabilisation was made viable by the fact that the Maziwiecki government, dominated by the Solidarity movement, enjoyed the population's trust and willingness to make sacrifices on the one hand and the support of the international financial organisations on the other. The latter meant support for stabilisation, credit from the World Bank, and the write-off of half of its interstate and, later, its commercial bank loans. Despite the favourable external circumstances, tough measures were needed here. After prices spiralled out of control in 1990, inflation was approximately 600 per cent (which is still lower than the approximately 900–1000 per cent inflation of the Baltic states). The zloty was made convertible, and its exchange rate was pegged to the dollar at the true market rate rather than at the previous official exchange rate; strict monetary and fiscal policies were introduced, and in this way, inflation was successfully curbed. Support for state corporations was cut dramatically. The lowest point of the recession was in 1990, when the economy shrank by 11.6 per cent (EBRD 1999: 73; Lehmann 2012).

Privatisation got off to a slow start, and by 1993, mainly the SMEs came under employees' ownership through lease schemes. The right-wing government did not want to sell off what were considered the key sectors either to managers belonging to the nomenclature or to the workers. The voucher-based privatisation began in 1994 within a strict legal

framework, thus avoiding corruption scandals similar to those of the Czech Republic (which we will discuss later). The management costs of the national investment funds executing the process were so high, however, that these failed to become an effective means of building the capital market (Soós 2010). Interest from foreign investors was also limited. Management buyouts became typical after 1993, when the post-communist successor party took power. The influx of foreign capital got under way following the write-off and the rescheduling of debt in 1994 (Belka 2001), but foreign investment plays a smaller role to this day than it does in the other Visegrád countries.

The development of labour relations got off to an unusual start in Poland because the main opposition force was the Solidarity trade union, and civil society was far stronger than in other post-socialist countries. Nevertheless, the 6-million-strong trade union membership of the beginning of the 1990s was halved by the end of the decade, with Solidarity members numbering approximately 1 million of these. By the time of EU accession, labour relations were very reminiscent of what was being experienced in the other Visegrád countries: a low level of institutionalisation and cooperativeness that stemmed from the helplessness of workers and conflicts that rarely became open. According to Polish experts, the path led from social partnership to enlightened paternalism (Pańków and Gąciarz 2001).

At the end of the 1990s, the Polish government resolved to carry out the reform of social services. The reform of pensions, healthcare, education, and regional government are referred to as the "four reforms". In stark contrast to the Baltic states, and similar to Hungary, the compensation for losses resulting from the structural transition to a market economy and the curbing of unemployment were resolved through the pension system. In comparison to the OECD average, the proportion of disability pensioners was higher, but early retirement reached an exceptionally high level. The reforms attempted to make the three-pillar pension system sustainable with respect to the future (Lehmann 2012). The education system was brought into line with labour market requirements, and performance incentives were incorporated into teachers' pay (Belka 2001). The transformation of the education system in the 2000s yielded results that were measurable in the PISA tests. In terms of R&D&I, Poland is

a moderate innovator, surpassing only Latvia, Lithuania, Bulgaria, and Romania (European Commission 2012).

Poland did not achieve as high a high peak growth rate as the Baltic countries, but its performance was more consistent. Therefore, relative to the 1989 base, Poland boasts the highest rate of growth among the ten post-socialist countries: prior to the crisis, in 2007, more than one and a half times, or 169 per cent, of its GDP at the time of the change in the political system (EBRD 2008: 13). Similar to the other Visegrád countries, Poland's industrial output was successfully restructured so that products of a high and medium technological level accounted for half of exports by the mid-2000s (Eurostat). However, the performance of the entire economy was impaired by the low productivity of agriculture. Even in 2008, the proportion of those employed in agriculture was 14 per cent, while the agricultural sector contributed only 2.2 per cent to GDP (European Commission 2010a: 47). Another reason for this result is that its income disparity indicators (risk of poverty, Gini coefficient) are better than those of the Baltic countries but worse than those of the other Visegrád countries (Table A.8).

One of the secrets of Poland's economic success is that while the governments carrying out reforms were punished by the population at elections as a matter of course (Donald Tusk's government was the first that managed to remain in power after the 2011 elections), successive governments did not dismantle each other's reforms, but merely modified them (Lehmann 2012). Polish economic policy, beginning with the first reforms, was committed to liberal solutions; it became a reliable implementer of IMF-inspired adjustment programmes, but this did not make its economic policy into a doctrine (Belka 2001). During the crisis, the clear signs of this Polish pragmatism can clearly be seen.

Following the change in the political system, the "velvet revolution" of 1989, the process of transition to a market economy also began in *Czechoslovakia*. The formation of this young state, which was founded in 1918, began in a context that differed markedly from the other two Visegrád countries. On the one hand, the system, which stiffened after the crushing of the 1968 "Prague spring", lacked the economic and political reform experience that the political and economic leaders of Hungary or Poland already possessed. On the other hand, the economy was more

stable, the Czech tradition of fiscal discipline had been retained by the communist leaders, there was no substantial public debt and per-capita GDP was second-highest, after Slovenia, among the ten post-socialist countries. Nevertheless, a finance minister was appointed to lead the economic reforms, in the form of Vaclav Klaus, who was a staunch proponent of neoliberal economic policy and who announced radical changes, the creation of a market economy "without adjectives" (that is, no social market economy). This process was irreconcilable with the continuation of support for the Slovak economy, which, during the socialist era, entailed the redistribution of up to 8 per cent of Czech national product to the Slovaks (Švihlíková 2011: 189). The trade liberalisation applied as a part of the shock therapy also took a greater toll on the Slovak economy. These tensions also contributed to the fact that on 1 January 1993, Czechoslovakia split into the independent Czech Republic and the Slovak Republic.

The *Czech Republic* was unable to avoid the recession brought about by the change in the direction of foreign trade, which reached its lowest point in 1991 at 11.5 per cent, the spiralling of prices and a more than 100 per cent depreciation of the Czech koruna brought 52 per cent inflation (EBRD 1999: 73, 76). The momentum of growth lasted until 1997, when the Czech economy sank into a mild recession, receding by approximately 1 per cent. The cause of this result was the unique brand of liberalism represented by Klaus, now in his capacity as prime minister. The Czech government opted for voucher privatisation because it expected that, in this way, joining the free market would not be limited by the situational advantage of the managers governing the companies, and it did not intend to put foreign capital in a more favourable position, either. The household vouchers, however, came to be owned by the privatisation investment funds established by the state-owned domestic banks, and the companies were not modernised and reformed either technically or in terms of their management. Thus, the competitiveness of Czech exports remained weak, while imports grew. The initially favourable position of the banks deteriorated due to the accumulation of bad loans. In 1996, the government introduced strict austerity measures; the unpopularity of these measures and the corruption scandals that accompanied the opaque process of the voucher privatisation led to early elections in

1998. The minority left-wing government was forced to sell the companies, which had been improved through the state restructuring agency, to foreign investors, as they did with the banks. The costs of bailing out the banks between 2000 and 2005 burdened the Czech budget to the tune of 1.5 per cent of GDP (Myant 2007).

All in all, the modernisation of the Czech economy was also based on FDI, and similar to the other Visegrádi countries, the automotive industry was the driving force. The rate of economic growth remained lower than in Poland or Slovakia, but to this day, it has retained second place in terms of per-capita GDP among the post-socialist member states. A major achievement of the Czech transformation was that, throughout the process, the high employment rate of over 70 per cent, which exceeds the EU average, was accompanied by 6 to 8 per cent unemployment (Eurostat).

In labour relations, the trilateral talks began promisingly, with a general pact in 1991. The combination of the Klaus government's philosophy and economic difficulties led to a situation in which the consultation mechanisms failed to develop into true corporatist institutions. The pension system was built up in a decidedly egalitarian way, and the employment difficulties were not resolved to the detriment of the system, as in Poland or Hungary, but through the provision of support to employers and with active labour market policy measures. Thus, there was no pressing need to privatise the pension system, which was reformed gradually, and only voluntary private pension insurance was introduced (Bohle and Greskovits 2012). The employment situation and the social insurance solutions led to low social inequality indicators despite the fact that the Czech Republic spends only 18–19 per cent of its GDP on social protection. Nevertheless, one may doubt whether the Czech data could be more favourable than the Finnish, Swedish, or Danish figures in terms of the risk of poverty, the Gini coefficient, or the EU 2020 poverty indicators. These doubts are reinforced by regional disparities, as in the Scandinavian countries, there is up to a one-and-a-half-times difference in per-capita GDP between the individual regions, while within the Czech Republic, there is a threefold difference (European Commission 2010b). The Czech government did not treat either R&D or education as a priority, and it produced indicators that were similar to its regional peers. The number of

participants in higher education and education spending remained below the EU average (Myant 2007).

Slovakia, owing to the shock therapy that began when the country was still part of Czechoslovakia, suffered a greater recession (–14.6 per cent) and higher inflation (58.3 per cent) in 1991 than the Czech Republic (EBRD 1999: 73). The less developed Slovak economy was hit harder by the collapse of the Soviet markets, and its tourism was far more modest than that of the Czech Republic. In 1993, the unemployment rate was not even as high as 4 per cent in the Czech Republic, while in Slovakia, it was over 14 per cent (EBRD 1999: 213, 265). Privatisation started with a small amount of restitution, the sale of small companies and, mainly, voucher privatisation. In Slovakia, the retention of state ownership and employee buyout schemes also remained popular alternatives. Following the transition to an independent state, the Mečiar government halted the privatisation and, in 1994, sold the large industrial corporations to domestic entrepreneurs, thus building up political clientele. However, this measure proved to be a temporary solution here, too, as the companies were sold to foreign investors either voluntarily or due to bankruptcy. The government tried to stimulate economic growth by squeezing the prices of public services below production costs and through infrastructure developments, with the latter financed by the state-controlled banks. The loose fiscal policy was paired with a strict monetary policy with high interest rates, which, although curbing inflation, was unable to prevent the emergence of twin deficits. While the Czech economy was negatively impacted by the 1996 narrowing of the western markets, the Slovak economy was impacted mainly by the 1998 Russian crisis. In addition to the economic difficulties, international isolation led to the fall of the Mečiar government, which was strongly nationalist and a threat to democracy. Slovakia was barred from joining the OECD, from the NATO expansion and from the start of the EU negotiations.

From 1998 onwards, the Dzurinda government switched to the neoliberal recipe also applied in the Baltic countries. The banks and public services were privatised, and attempts were made to attract FDI in industry, costs were cut and the koruna devalued. Owing to the stability of the economy, from 2000 onwards, Slovakia set off on a path of dynamic growth, with FDI bolstering industry here, too, especially the automo-

tive industry. The sustainability of growth was provided for by the structural reforms of the second Dzurinda government from 2002 onwards. The introduction of the flat tax system had greater international reverberations than the similar Baltic or Czech measures due to its consistent implementation. The pension reform reduced the state's commitment in the long term; the restructuring of the first pillar was accompanied by the introduction of a mandatory second pillar. By liberalising the labour market and reducing welfare transfers, the intention was to boost economic activity. In the favourable global economic environment, employment began to rise. The education reform was mainly successful only in terms of financial stabilisation and the restructuring of the institutional system in line with the declining number of children. The performance of the healthcare system triggered such general discontent that radical marketisation was seen as the solution. In this area, however, they were no longer able to consistently implement the accepted reforms (transformation of the hospitals into incorporated business entities and the insurers into profitable management organisations). The dramatic changes that were expected on the basis of the election campaign rhetoric of the left-wing Fico government elected in 2006 failed to materialise. The privatisation of public services was halted, and a few popular measures with a low budgetary impact were adopted (for example, they abolished the patient co-payment in the health sector), and joining the second pillar of the pension system was made voluntary (Beblavy 2010). With its reforms, Slovakia not only came out of international isolation and became a member of the OECD, NATO, and the EU, but in 2009, it was able to adopt the euro.

With regard to labour relations, at first, the trilateral corporatist negotiations worked in Slovakia, but this practice was unable to take root under Mečiar's authoritarian rule. Although the Dzurinda government passed a law on social partnership in 1999, against the backdrop of the austerity measures and later reforms, this law did not work in practice (Bohle and Greskovits 2012). In Slovakia's case, exceptionally favourable income disparity indicators are found. These indicators are slightly worse than those of the Czech Republic but remain close to those of the Scandinavian countries, which is why one can doubt their reliability even more than that of the Czech data (Table A.8). This result is difficult to

believe, given the social spending amounting to 17–18 per cent of GDP, an unemployment rate that never fell below 10 per cent (Eurostat), and a Roma minority, which was stricken by similar education and employment problems, of a similar proportion to that of Hungary. Additionally, there is a four times difference in per-capita GDP at PPP between the Slovak regions, which is even greater than in the Czech Republic (European Commission 2010b).

If we analyse Slovakia's performance since 1989, then only Poland's 169 per cent GDP growth was enough to surpass its previous 154 per cent. If we look at the EU-27 average, Slovakia needed the "helping hand" of the 2008 crisis to overtake Estonia, thus coming third among the post-soviet countries after Slovenia and the Czech Republic (EBRD 2008:13, Eurostat). Slovakia achieved this impressive convergence in such a way that successive governments did not devote as much attention to either R&D or education as Slovenia or Estonia.

Hungary is the last to be discussed not out of courtesy by the Hungarian author to the neighbouring Visegrád countries, but rather because the path of this country's development has differed to a certain extent from that of the previous three, especially since the beginning of the 2000s. These differences can be attributed partly to the legacy of the past and partly to economic-policy decisions.

In 1956, Hungarian society rebelled against the dictatorship, and although the uprising was rapidly crushed, it had a profound effect on the communist party leadership. From the mid-1960s onwards, the essence of consolidation under Kádár was intended to make up for the missing political legitimacy by improving prosperity. To this end, the 1968 economic reforms brought changes that were unparalleled in the entire eastern bloc. Following a number of setbacks and renewed efforts, by the time of the change in the political system, several institutions of the market economy had already been created (for example, the partial liberalisation of prices, partial freedom of enterprise, a two-tier banking system, the introduction of personal income tax and value added tax, and so on). However, not even the partial reforms resolved the efficiency problems of the state socialist system, so the modest but constantly rising household consumption serving the political stability of the system could

be covered only by growing public debt. In 1990, the gross public debt exceeded USD 21 billion (Kornai 1996: 956).

The National Round Table Talks conducted between the Hungarian Socialist Workers' Party and the opposition parties in 1989 ensured a peaceful transition. At the first free elections held in 1990, a right-wing coalition received a mandate to govern, led by the Hungarian Democratic Forum (MDF) with József Antall as prime minister. With its slogan of "quiet strength", MDF attracted voters who highly valued stability, and the state of the Hungarian economy did not require the use of shock therapy as Poland did. Although the recession was severe in Hungary, too, bottoming out in 1991 at 11.9 per cent, inflation never turned into hyperinflation (inflation was 32–33 per cent in 1990–1991), nor did the liberalisation process have to begin from scratch (EBRD 1999: 73, 76).

The burdens associated with the transformation soon triggered resistance; in response to a petrol price increase planned by the government, a blockade by taxi drivers brought Budapest's traffic to a standstill in October 1990. Although the price increase was necessary, the opposition took the side of the taxi drivers. The government arrived at a settlement with the taxi drivers through the Reconciliation Council, and the drivers received price compensation. Two decades on, with hindsight, this conflict began to reveal the traits that would prevent Hungary from maintaining its initial position as the frontrunner of the change in the political system. The vast majority of Hungarians, who, compared to their neighbours, had lived in relative freedom and affluence, expected the change in the political system not only to bring freedom but also to quickly allow them to enjoy the affluence of the western countries. The government could not rely on the same willingness to make sacrifices as in the case of the Baltic countries or Poland. With the deep political divisions, whoever was in opposition at any given time had no compunctions about exploiting longings for prosperity in order to gain power in the short term. Thus, the successive government never embarked on comprehensive reforms except when they were forced to do so by macroeconomic imbalances. These measures were softened either by themselves or by their successors at the first opportunity; therefore, they returned to the path beaten by the party leadership under Kádár. The expansive fiscal policy, which exceeded the country's load-bearing capacity, and the

"stop and go" economic policy that accompanied it could justifiably be interpreted as the manifestation of a path dependency that spanned the change in the political system (Benczes 2011).

In Hungary, not only liberalisation but also privatisation had begun before the change in the political system with the 1988 Companies Act; however, these processes took place on a large scale only in 1990 onwards. The free distribution of property was not supported either by economists or by economic policy makers, but it was out of the question anyway due to the country's indebtedness. The restitution and employee ownership program continued to have little significance. The acquisition of ownership by Hungarian nationals was supported with preferential privatisation loans. Unlike in the other post-socialist countries, the sale of the larger corporations to foreign owners had begun in 1988, and the first substantial waves of sell-offs took place in 1992–1993 (Soós 2010). The socialist-liberal government that took power in 1994 restarted privatisation in 1995, selling energy companies and—after their restructuring—banks to foreign investors. However, an analysis from the period noted that, in many cases, cannot talk about privatisation in the strictest sense of the word for energy companies because these companies were bought up by foreign state or community-owned companies (Voszka 1996). Overall, in Hungary, after the primary privatisation and owing to the green field investments, FDI led to the emergence of a competitive export structure.

In 1995, the macroeconomic imbalances forced the implementation of the package of austerity measures named after the then-finance minister Lajos Bokros, comprising forint devaluation, surplus import duty, welfare spending cuts, and a wage freeze (Kornai 1996). Economic growth began and the public debt shrank due to the privatisation revenues. Hungary seemed to be on a sustainable growth curve, which was maintained by the right-wing government following its 1998 election victory until the spending spree in the run-up to the 2002 elections. The socialist-liberal coalition regained power with the promise of a "welfare regime change". As a result of the budgetary spending, the public debt began to grow again, and the households also became externally indebted through foreign currency loans advertised with low interest rates. The government employed various tricks to buy time until the 2006 elections, which it

won, but afterwards, it had no choice but to impose austerity measures. Hungary's convergence, in terms of per-capita GDP at PPP, stalled at 62–63 per cent for several years beginning in 2003 (Eurostat). Hungary entered the 2008 crisis with a weakened economy, and the government no longer had the elbowroom to pursue an anti-cyclical economic policy.

Labour relations developed similar to those of the other Visegrád countries. The Reconciliation Council's successful handling of the taxi blockade was not followed by a strengthening of trilateral interest representation. Among the trade unions, the communist legacy organisation, the National Federation of Hungarian Trade Unions, became the largest, but none of them developed into influential employee organisations. During successive governments, there were nuanced differences, but the position of employees and social partnership remained just as weak as in the previous three countries. Among the Visegrád countries, Hungary had the highest social spending, a factor in this was that, similar to Poland, the burden of the unemployment resulting from the change of economic structure was borne by the pension system. In 1998, the financing of pensions was restructured to form a three-pillar system, of which the second pillar—compulsory private pension funds—was nationalised by the Orbán government in 2010 (Bohle and Greskovits 2012).

In terms of innovation performance, Hungary comes second among the Visegrád countries, following the Czech Republic, which holds 17th place overall, at 19th in the ranking of the 27 member states (European Commission 2012). As the PISA report mentioned above shows, in terms of education, Hungary falls in the middle of the European ranking. The financial conditions for improving educational performance, however, are less favourable than in the other Visegrád countries. Although GDP-proportionate spending on education was lower in the Czech Republic and in Slovakia than in Hungary, in Hungary, this spending has been falling steadily since 2006 (Eurostat).

4.6.4 Slovenia's Separate Path

Of the countries discussed so far, none has such a starkly different assessment in the literature as *Slovenia*. Its population of two million, similar

to the Baltic states, is on the scale of a city state, but Slovenia was the only one of the post-socialist countries to have since become EU member states to choose a radically different path of transformation. This difference is also reflected in my cluster analysis, as although the country falls into the CEE group, it is on the borderline with the North-Western (continental) countries. For researchers, Slovenia is a kind of test bed, regarding which the question can be put, and possibly answered, of whether it would have been possible to transform the state socialist system into an institutional setup more akin to the old, North-Western member states, and what conditions would be necessary to do so. For this reason, more space is devoted to the study of the Slovenian transition than would otherwise be warranted by the country's economic weight.

As an independent state, Slovenia is even younger than the Baltic states, as it has existed only since 1991. Slovenian tribes arrived in the Balkans as early at the sixth century, but they lived as a part of the German-Roman Empire and, later, the Habsburg Empire. By the collapse of the Austro-Hungarian Monarchy, the industrialisation of the Slovene-inhabited regions had begun, but agriculture still dominated. Two-thirds of the Slovenian population became a part of the Kingdom of Serbs, Croats and Slovenes that was established after WWI and later of 1929 Yugoslavia, while the remaining one-third became a part of Austria and Italy and has shrunk to a minority numbering a few tens of thousands. In this new state framework, Slovenia was the most advanced unit, as Slovenian per-capita national product exceeded the Yugoslavian average by 60 per cent (Ferfila and Philips 2010: 8). Slovenia became the engine of industrialisation and benefited from the relatively large Yugoslavian internal market. This process of development was halted by the Great Depression of 1929 and later by the occupation of Yugoslavia in 1941. After WWII, Slovenia began to build up a Soviet-type planned economy, but the Tito-led state's split with the Soviet Union also brought new economic policy solutions. The establishment of self-management in corporations was accompanied by political decentralisation; decision making moved from the national level to the level of the member republics. The abolition of the planned economy and the strengthening of ties with western economies led initially to dynamic, 5 to 7 per cent growth in Yugoslavia as a whole and, specifically, in Slovenia. This workers' self-management or market social-

ism, however, increasingly came to be ruled by the logic of the communist political system. Statism was revived at the level of the member republics, and the institutions of self-governance were hollowed out. After the 1973 oil crisis, Yugoslavia—like Hungary—tried to keep itself afloat by relying on foreign loans. In the 1980s, in economic terms, Slovenia was already functioning as a virtual independent state that, similar to the other member republics, was effectively stagnating while struggling with inflation of 30–40 per cent, peaking at 1385 per cent in 1989 (Ferfila and Philips 2010: 18–20). After a referendum, Slovenia announced its separation from Yugoslavia in 1991, and the predominantly Serbian Yugoslav army responded with a military assault. Owing to the ethnic homogeneity of Slovenia and the support of the West, the war lasted only ten days and ended with few losses. Following the introduction of political democracy, the transformation of the country to a market economy began. Owing to the loss of the Yugoslav markets and to the Balkan war, the economic transition sparked a recession in Slovenia, which reached its lowest point in 1991, with an 8.9 per cent drop in GDP (EBRD 1999: 73).

The Slovenian leadership chose a method of economic transition that truly fits the description of gradualism usually described in the literature, given several factors. The last Yugoslavian Prime Minister, Ante Marković, embarked on radical market reforms in 1989, which led to a dramatic economic recession. Slovenian workers reacted to the first attempts at stabilisation after independence with a wave of fierce strikes. The left-leaning orientation of the majority of society was also reflected in the election results. The Liberal Democracy of Slovenia, although not the communist successor party, but a spin-off of the former young communists organisation, became the leading force in the coalition at the first free elections in 1990, and the president's chair was taken by a reform communist politician. The unstable Western Balkan environment also may have provided an incentive for the government to avoid further shocks, and in spite of the various economic problems, the workers' self-management system provided the foundations for the construction of a neo-corporatist decision-making system (Rojec et al. 2004; Soós 2010; Stanojevic 2005). Yugoslavian market socialism, despite the distorted nature of the market relationships, provided extra know-how at the start of the transition in comparison to the countries that transitioned directly from a planned

economy, as in the case of the reforming Hungary. Unlike the latter, however, it did not have a public debt so large as to remove any possibility of choice.[14]

The stabilisation of the economy began in 1991 with the introduction of the independent currency, the tolar. The market reform index used by the EBRD, as well as other indexes measuring economic freedom, unanimously show that Slovenia made progress in building a market economy, but at a slower pace than the Visegrád and Baltic countries. Slovenia put in place the conditions necessary for EU membership but maintained a higher degree of state intervention (Pezdir 2006; Šušteršič 2009). The uniqueness of the Slovenian path, besides the neo-corporate nature of the employer-employee relationship, lies mainly in the country's attitude towards privatisation and FDI. In the first step, similar to other countries, employer and employee acquisition and voucher-based privatisation represented the means of transforming ownership relationships. However, there was no "secondary" privatisation; in other words, a substantial degree of employer ownership remained, and the corporations and banks that had been nationalised after the workers' self-management form of "social ownership" remained under state ownership. The role of FDI continued to be far more limited than in the other post-socialist countries of the EU (Soós 2010).

Until the crisis, Slovenia showed impressive performance in terms of its convergence; in 1995, its per-capita GDP was 74 per cent of the EU-27 average, which was the most favourable figure among the 10 transitioning economies, and by 2008, this figure had risen to 91 per cent (Eurostat). In terms of its innovation performance, Slovenia is also close to the EU average, at the forefront of the "post-socialist camp" (European Commission 2012); much attention has always been devoted to education, and Slovenia's social system places it clearly among the continental countries. Although initially, a relatively expansive monetary policy was used to stimulate the economy, Slovenia nevertheless succeeded in reducing inflation, and this was the first of the countries that joined the EU in 2004 to adopt the euro in 2006.

One striking point of view in the assessment of the Slovenian path places Slovenia, based on the features of privatisation, in the same group as Russia and Ukraine (Soós 2010), although based on the results men-

tioned above, this is very formal and unconvincing preposition. Bohle and Greskovits (2012) point out that what can be observed in the Slovenian economic policy is not a general anti-FDI or protectionist attitude but rather deliberate selection. Unlike the banking and utility sectors and those based on simple work (for example, the textile and lumber industries), in the complex sectors, FDI has an important role, on a par with that ascribed to it in the Visegrád countries, which also explains Slovenia's export performance. At the same time, the impact of the 2008 crisis shows that not even this latter, clearly positive assessment gives the complete picture. Slovenian authors, through their detailed analysis of the export structure and competitiveness traits, have long warned that Slovenian gradualism has reached its limits and that, without further reforms, the growth achieved to date is not sustainable (Pezdir 2006; Rojec et al. 2004; Šušteršič 2009). Later, in the discussion of the management of the crisis, the question of whether the Slovenian path will remain viable after the corrections or whether a change of model is unavoidable will be discussed at length.

4.6.5 South-Eastern Europe: Romania and Bulgaria

The two South-Eastern European countries took paths that were similar to each other but different from those of the other post-socialist EU countries. Initial gradualism did not lead to a development path similar to Slovenia's; instead, the steps of liberalisation, institutionalisation, and privatisation were taken after a protracted transition.

The change in the political system in *Romania* swept away the most violent dictatorship in CEE. The horrors of the Ceauşescu system, including the bankrupted economy, the destruction of villages, and the attempts to absorb and exile Hungarian and Saxon minorities, were known throughout Europe. The party leader, who was in power since 1965, had built up a personal cult and maintained political oppression that, in the 1980s, was unparalleled in the region. The revolution that began in Timişoara in December 1989 brought Ceauşescu's rule to an end quickly, and the number of fatalities topped one thousand. The president of the National Salvation Front, Ion Iliescu, set up a tribunal that sentenced Ceauşescu

and his wife, who held various political posts, to death; the sentence was carried out immediately, on 25 December 1989[15] (Bottoni 2009).

This dramatic end by no means marked the beginning of a radical transformation. The communist successor party and its leader, Iliescu, won the elections and indeed remained in power until 1996. A circumstance that favoured the transformation was that, in order to achieve independence from the West, Ceaușescu had to repay the public debt, albeit at the cost of hardship for the general population. The economic slump was not exceptionally pronounced in comparison to that of the Visegrád countries, and it reached its low point in 1991 at –12.9 per cent, while inflation between 1991 and 1993 was 200–300 per cent (EBRD 1999: 73, 76). Price liberalisation and currency devaluation were not followed by structural reforms; the loss-making state-owned corporations received assistance, which temporarily slowed the growth in unemployment. Thanks to these measures, between 1993 and 1996, the economy grew by an average of 4 per cent. Privatisation got off to an awkward start; aside from the agricultural restitution, the employer and employee buyout method was used only among SMEs. The government deficit was not high (around 3 to 4 per cent), but a substantial part of the actual budgetary burdens remained hidden among debts between state corporations and tax arrears owed to the budget. It was possible to push inflation down only by overvaluing the currency. Another sign of the unsustainability of the economic processes was the growing balance of payments deficit (Scrieciu and Winker 2002: 6, 18).

Seeing these economic difficulties, the right-wing coalition that came to power in 1996 committed itself to accelerating the reforms, that is, to "shock therapy". Prices began to be liberalised in the agricultural and energy sectors, which together with the indexing of wages and loosening of monetary policy, scaled inflation back by more than 150 per cent by 1997, returning to single digits only in 2005. The economy shrank every year between 1997 and 1999 at an average rate of 4.4 per cent. In 1998, a stabilisation program began with the support of the IMF. The privatisation programme was extended to large state corporations, which were sold off to foreign investors on a large scale. Direct assistance for the remaining state corporations was reduced, but the low energy prices and the credit guarantees, which were usually paid out of state coffers,

continued to represent concealed subsidies. Given these economic difficulties, unemployment was not exceptionally high (at approximately 10 per cent) because the agricultural sector served as a buffer (Ahrend and Martins 2003; Scrieciu and Winker 2002: 6–8).

The recession that came with the transformation dramatically increased poverty, which, in 2000, helped the left to regain power, so the results of the start of economic growth came to fruition when they were in government. Once again, there was an attempt to return to gradualism, but the EU accession talks that began in 2000 marked the path of the institutional reforms. The 4 to 8 per cent growth rate remained until the 2008 crisis (Eurostat). The structure of the economy developed less favourably than in the Visegrád countries. The share of agriculture, even in 2008, was the highest in the whole of the EU both in terms of GDP (6.0 per cent) and in terms of employment (28.8 per cent) (European Commission 2010a: 47). In the industrial sector, seeing the inability of the state's heavy industrial corporations to compete, Romanian businesses were able to secure comparative advantages in the labour-intensive branches of light industry (textile, footwear, and lumber). In light of the above, it comes as no surprise that in 2011, Romania was ranked 24th in the EU in terms of its innovation performance (European Commission 2012), and the performance of its economy is made possible only by the low level of welfare provision and modest funding for education.

The trade unions responded to the economic recession with fierce strikes. Due to the state's weak public policy and public administration performance, however, a tripartite consultation system failed to emerge. The left-wing governments were afraid of the workers' movements, but the treaties on social dialogue never had any impact. Therefore, even if they had wanted to, the trade unions could not have pursued a moderate strategy because the governments were incapable of credibly promising any future results with the potential to offset the short-term sacrifices (Bohle and Greskovits 2012).

Bulgaria embarked on a process of building democracy after a peaceful transition. In contrast to Ceauşescu, who strove for independence even from Moscow, Bulgaria's government had been the Soviet Union's most faithful satellite, which did not give rise to antipathy on the part of the population. Todor Zhivkov led the Bulgarian Communist Party

between 1956 and 1989, but he did not build as extreme a personal cult as Ceauşescu. The rigid planned economy reached the limits of its capacity by the 1980s, and the Bulgarian party leadership attempted to compensate for the declining economic growth with foreign loans. As in Romania, the "nationalism card" was played here, and the oppression of the 10 per cent Turkish minority became a source of international friction. These economic and political difficulties, as well as the encouragement provided by Gorbachev's glasnost and perestroika, led to opposition movements and mass demonstrations. In an effort to maintain power, the reformers in the party leadership removed the ageing Zhivkov, whose place was taken by the foreign minister Peter Mladenov, who entered into negotiations with the opposition. The first free election was held in 1990. A stable government was not formed until 1996, however, because in three elections, five governments did not receive a clear mandate to carry out market reforms. The dominant force was the socialist successor party, which planned to arrive at a market economy after a 20- to 25-year transition (Frye 2010).

The economic recession reached its low point in 1991, at –11.7 per cent; then, in 1994–1995, three years of shrinkage gave way to growth of approximately 2 per cent. Inflation exceeded even that of Romania, at 339.9 per cent in 1991, and did not fall much below 100 per cent in the following years. The unemployment rate was between 11 and 16 per cent throughout the 1990s (EBRD 1999: 73, 76, 205). The paradoxical reform policy could not have yielded any other result. In an economy that was geared almost entirely to supplying the Soviet markets, trade was liberalised and price controls lifted, but in 1994, controls on a number of prices were reinstated. On the one hand, the government tried to use the unified exchange rate as a nominal anchor and narrowed the monetary supply; on the other, the government supported loss-making corporations through state-owned commercial banks. A law was passed on privatisation, but in practice, company managers who were affiliated with the party state, the supporters of the successor party, benefited from a concealed privatisation process and were able to build their own corporations from the profits sucked out of the state corporations. The voucher-based privatisation scheme and employer and employee buyouts, also provided an opportunity to build up a clientele. FDI steered clear of Bulgaria,

which was not due solely to the uncertain business environment. In 1990, Bulgaria suspended the repayment of its debts; its foreign debts exceeded USD 12 billion. The negotiations and restructuring of debts took three years, and Bulgaria made its full return to the foreign capital markets around the turn of the millennium (Mihov 1999: 7–8, 38).

By 1996, the postponed reforms had pushed the country into another recession, which again ran to double figures (–10.1 per cent), while inflation shot up to over 300 per cent, with the following year's average exceeding 1000 per cent (EBRD 1999: 73, 76). In the wake of the failures of the transition, in 1997, a strong majority of votes was scooped up by the right wing, which was committed to liberal reforms. The employer and employee buyout programs that began with the socialists were continued, but forgetting their own criticisms, voiced in opposition, the right-wing government also used these to reward their supporters. A new development was that large state corporations were also privatised either by direct sale or through the stock exchange, this time to foreigners as well (Frye 2010). The new government managed to reach agreement with the IMF and also began to implement the stabilisation program that it supported. Trade and price liberalisation continued. A key element of monetary policy was the establishment of a currency board; the lev was pegged to the Deutschmark. A disciplined fiscal policy was introduced, and tax collection was improved. Owing to these measures, inflation decreased, falling to single digits from the turn of the millennium onwards, and the banking system was also successfully stabilised (Demopoulos and Fratzekos 1998). Until the 2008 crisis, economic growth settled at a level of 5 to 6 per cent, while the unemployment rate did not fall below 10 per cent until the last few years before the crisis. The ability to sustain these results was helped by the fact that the deep political divisions abated. Interestingly, a factor in this process was that the 2001 elections were won by a new moderate right-wing party headed by the one-time Bulgarian Tsar Simeon II, who lived as an emigrant up until 1996 (Frye 2010).

The structure of the economy in Bulgaria, similar to that of Romania, is characterised by a share of agriculture that, even in 2008, exceeded that EU average, accounting for 5.5 per cent of GDP and 7.5 per cent of employment (European Commission 2010a: 47). The country's ability to attract foreign capital increased in the 2000s, with the ratio of FDI

to GDP exceeding that of the Visegrád countries by the middle of the decade. In terms of its structure, however, as in the Baltic countries, the FDI went mainly into the financial sector and property development and less into the tradable sectors.

With regard to labour relations, welfare provision, the innovation system and education, Bulgaria's story is very similar to that of Romania. In Bulgaria, too, workers responded initially to the economic recession and the difficulties entailed by the market reforms with strikes. The ability of the trade unions to mobilise failed to result in tripartite consultation and a neo-corporatist system. There is good reason to assume that in Bulgaria, the weakness of the state was the key factor ensuring that the agreements on social partnership were not followed by actions (Bohle and Greskovits 2012). The EU's poorest member state clawed its way back to achieving 66 per cent of its 1989 GDP in 1998; therefore, it was able to maintain a very reduced level of welfare services and educational expenditures. In terms of innovation performance, Bulgaria is ranked 26th among the EU member states (EBRD 1999:73, European Commission 2012).

The growth of the 2000s was accompanied in both countries by (primarily external) macroeconomic imbalances, which, even before the 2008 crisis, foretold stalling growth.

4.7 A Unique Feature of the Central and Eastern European Model: Modernisation Based on FDI

Having reviewed the transitions of the individual countries, I now summarise the conclusions that can be drawn on the basis of the capitalist transformation because, when making the comparisons, I was confronted with results that are inconsistent with generally held beliefs. Additionally, this summary allows me to verify the findings regarding the CEE model made in connection with the cluster analysis. I separately scrutinise a defining features of this process, namely, the fact that the modernisation process was founded on FDI.

4.7.1 Lessons of the Transition

The current crisis in the euro area has given broad scope for Eurosceptic thinking. Taking a longer historical view, it must be emphasised that in the post-socialist countries, the opportunity for EU membership and the preparations for this membership played an exceptionally important anchoring role in the course of building the market economies. The significance of these factors was enormous from two perspectives. On the one hand—as Csaba (2009a) analyses in detail—neither the economists of the post-socialist countries nor the advisors of the international organisations were equipped to carry out the transition from socialism to capitalism. Apart from a general framework outlining a combination of stabilisation, liberalisation, institution building, and privatisation, the specific recipe adapted to the region's characteristics was not available. In the absence of the appropriate theoretical background, after the initial steps of macroeconomic stabilisation, the adoption of community law provided a point of reference for building up the institutional system of the market economy. On the other hand, the efforts to join the EU also helped the transition to be carried through in countries where the internal power structure might have otherwise made it highly likely to become stuck in "patrimonial" (King 2007) or, to use another term, "uncoordinated" (Lane 2007) capitalism. Without EU membership, through their historical traditions and under the influence of post-communist forces, Bulgaria and Romania would have most likely drifted onto a path similar to that of Ukraine or other CIS countries. The IMF and international experts also influenced the transition, but countries turned to the IMF only as a last resort. Bulgaria's example is a good illustration of this limited scope of influence. The IMF attempted to reach agreement for years in vain, which yielded a result only when the internal political relationships changed in response to the protracted crisis. In places where the IMF was able to act more quickly and more effectively, such as Poland or Estonia, this process was made possible by the willingness of the government and society to reform.

In the literature, the steps necessary for the transition from a state socialist economy to a capitalist market economy are commonly referred to as the "SLIP" agenda, an acronym for Stabilisation Liberalisation,

Institution building, and Privatisation. A study of the individual countries has confirmed this to be a sound interpretive framework. The literature does not, however, support the commonly held view that what took place in the region was adherence to a consistent neo-liberal recipe suggested by international organisations. Csaba (2009a) points out that the contrasting of gradualism and shock therapy in the transition literature draws attention away from the more important issues. This assessment is emphasised by a study of the transformation of the individual countries. The general frameworks of the transition were determined by theoretical insight; however, the choice of specific solutions can be much more effectively explained by the historical legacy, that is, the political and economic circumstances, than by the impact of theory.

The transformation as a whole cannot be perceived as a comprehensive course of shock therapy; the privatisation took place at a different time than did stabilisation and liberalisation, even in the Baltic countries that chose the most radical transformation. Institution building in the economic—or, more precisely, the institutional economic—sense is by no means the same as formal organisational restructuring. The permanent alteration of the rules of play and the solidification of the new institutions are clearly possible only as outcomes of a longer historical process. In terms of the speed of stabilisation, the extent of the imbalances left genuine opportunities to choose in only a handful of cases. It can be said of Czechoslovakia that, in spite of the country's stable economic situation, Klaus announced a radical program of reforms that was—as we have seen—unacceptable for the Slovaks. In Hungary's case, one can talk about genuine gradualism only in the sense that the reform socialist measures involved the introduction of certain market institutions. After the change in the political system, the process of liberalisation and transformation of the ownership structure took place rapidly in comparison to the region's other countries. Romania and Bulgaria did not transform gradually, either, but instead postponed the reforms before taking the same steps that had been implemented immediately by the Baltic countries. We can talk about a deliberate gradual transformation only in the case of Slovenia, which was in a position to do so by virtue of its special characteristics, although it, too, has now reached the limit of this capacity.

Every country except Hungary experimented with the creation of national capitalism. In Hungary, this phase was omitted due to the country's high public debt, and even the strongly nationally oriented Antall government began to sell off corporations to foreign investors. This result indicates that the key role of FDI stemmed not from any commitment to a neoliberal doctrine, but rather from a lack of capital and management knowledge. In the Baltic countries, the governments' adherence to neoliberal economic policy was something of a means to an end; they saw in it a guarantee of emancipation from the former Soviet empire. As described above, this commitment was not the same for each country and was also proportionate to how threatened the countries felt by the Russian minority. A neoliberal conviction without any external compulsion was found where the Klaus government was concerned, but the launch of voucher-based privatisation showed that the government did not want to give preference to foreign capital. However, every country except Slovenia sooner or later made an effort to attract FDI. In Slovenia, however, non-foreign-owned property means state property, the well-known drawbacks of which had become serious and inevitable by the time of the 2008 crisis.

The importance of the historic legacy is also underlined by the development of labour relations. Nowhere—with the exception of Slovenia—did the workers' movements, temporarily strengthened by the change of political system, give rise to neo-corporatist employer and employee relationships similar to those of Western Europe. Thus, the region returned to the historic path that was characterised by weak representation of workers' interests, which is modified more or less as a formality by the requirements of EU laws.

4.7.2 Growth Opportunities and Limits in the Central and Eastern European Model

The literature fully agrees that a defining feature of the CEE transformation was modernisation based on FDI. In a comparison of the EU-27 member states, the unique character of the post-socialist member states lies not in the high volume of FDI relative to GDP, but in the asymmetry

of the sizes of the inward and outward FDI stocks (Table A.9). Among the OMS, the ratio of inward to outward FDI stocks does not exceed two, even in the countries with the lowest per capita GDP (Greece, Portugal); among the post-socialist countries, only Slovenia has a ratio below two, accompanied by the lowest GDP-proportionate rates, while for the others, these rates are between 2.82 and 61.53 (Romania's and Bulgaria's are above 60).

As seen above, King (2007) places emphasis on dependency when talking about the Visegrád states as liberal dependent countries. Nölke and Vliegenhart (2009) simply view dependence on FDI as an element that defines every material aspect of their model elaborated for the Visegrád countries. Bohle and Greskovits (2012) paint a more nuanced picture, pointing to the significance of the distribution of FDI between the sectors; that is, whether it went into tradable sectors because only in this case can it support sustainable economic growth.

The Commission produced an assessment on the fifth anniversary of the EU, in which it sees the influx of FDI as a source of successful integration of the NMS (European Commission 2009b). In the midst of the crisis, the World Bank's experts published a book on how the European model could be restored to its former glory, and in this, the successful FDI-based model of the CEE countries is compared with the unsuccessful model of the Mediterranean countries based on portfolio and other capital flows (Gill and Raiser 2012).

In order to assess the growth prospects of the CEE countries, we need to examine in more detail whether, based on experience to date, the region's long-term convergence can be ensured by FDI-based economic development. According to economic theory, FDI supports growth in the receiving country's productivity via two channels: directly through investments on the one hand and indirectly through the spill over effect on the other. The latter is especially important because this is how FDI can be expected to promote the modernisation of the domestic economy. A great many empirical studies have been made of these impacts on the CEE countries. From two wide-ranging literature reviews, it can be inferred that in the vertical backward linkages, the impact of FDI was clearly productivity boosting, while in the horizontal linkages, the majority of the studies could demonstrate only a weak relationship (Gorodnichenko et al. 2007;

Hanousek et al. 2010). A study by the ECB also listed extensively the often-contradictory empirical analyses found in the literature. Their own measurement found a positive linkage between FDI influx and productivity growth; however, the authores note that this is not automatic, but depends on the absorption capacity of the receiving country (Bijsterbosch and Kolasa 2009).

The aforementioned EU research (European Commission 2009b) and that of the World Bank both take into account the results of econometric studies on the role of FDI. However, they go beyond these and evaluate the development of the CEE countries along the lines of a very similar logic. According to both analyses, the chief strength of this model is that, in addition to facilitating economic growth, it facilitated the emergence of a capital-intensive export structure conforming to high technological standards. The openness of trade, the influx of FDI and the institutional development due to the EU accession were the main drivers of growth. The Commission's report highlights that, "during the period 2000–2008 accession the NMS an extra growth boost ... Model simulations suggest … the NMS enjoy a 50–100 basis point advantage relative to other emerging economies with comparable fundamentals" (European Commission 2009b: 17). The Commission's report also examines the processes from the perspective of the OMS. On the one hand, few jobs were lost to the relocation of production because some 70 per cent of the FDI went into market acquisition and services. On the other hand, in many sectors, it was possible to maintain competitiveness only by moving production facilities, while retaining the part of production that required specialist know-how, technological development, and ownership. The report does not, however, mention what kind of limitation these features of the FDI movement could represent in the longer term from the perspective of the convergence of the CEE countries.

Gill and Raiser (2012) emphasise that Europe is the only region in the world in which capital flows in the "right" direction; that is, into the poorer countries with a higher growth rate. They attribute the success of the convergence to the fact that the companies of the Nordic and North-Western countries restructured their value chain after the fall of communism. These companies relocated their assembly operations to the NMS, and the low wages there strengthened their competitiveness. This was also

beneficial for the NMS because it allowed them to integrate the global economy with increased productivity. They regard the EU as a three-speed union, with the leading Nordic and North-Western countries, the eastern followers, and the laggard southern countries.

None of the analyses asks the question of whether this model makes it possible to achieve, in the longer term, the ultimate goal of the CEE countries, namely, to converge with the living standards of the Western European countries. These studies outline a division of labour, in terms of production, between the North-Western countries and the CEE countries. Although this does not preclude the possibility of subsidiaries in the latter countries climbing higher up the value chain, there is no reason to assume that the parent companies will surrender their key positions in innovation, technology development, and strategic decision-making. The development of domestic companies—as the empirical studies quoted above have shown—is promoted considerably only among the suppliers by the technological transfer that comes with FDI; the horizontal impact is minimal. The third opportunity could be the accumulation of capital based on domestic savings, but in CEE, the high level of FDI influx was accompanied by a low level of savings, unlike in the emerging Asian countries.

As shown earlier in relation to Ireland, how difficult it is in an emerging country, even with several decades of deliberate economic policy, to narrow the productivity gaps between domestic and foreign companies. Empirical surveys show that even in the developed countries, there is a general tendency for the economic performance of multinational corporations to be better than that of domestic companies. Possible reasons for this include the fact that multinational companies are present in the sectors with a higher R&D content than the domestic companies; however, the state incentives for FDI could also put them at an advantage. From this, Bellak (2004) draws the conclusion that the differences in performance between the companies are determined not by their foreign or domestic nature, but rather by whether they are multinational or bound to a national economy. Therefore, economic policy should concentrate not on ownership, but on eliminating the performance gap. This distinction is appropriate in the developed countries. However, in the case of emerging countries that are weak in capital, the two approaches over-

lap considerably. The comparison of Ireland and Sweden by Andreosso-O'Callaghan and Lenihan (2011) showed that, in contrast to Ireland, Sweden's foreign companies are more evenly distributed across the industrial and services sectors, while the export-oriented and high-tech sectors are dominated by domestic companies. There are no data for a wider-ranging international comparison, but a good approach to the problem is to compare the productivity of the large corporate and SME sectors, for which EU data sources are available. The 2007 data are still unaffected by the impact of the crisis (Fig. 4.1).

Figure 4.1 clearly shows that—with the exception of Poland—the gap between the large corporate and SME sectors is the greatest in the countries that are struggling with the greatest difficulties in the present crisis. Among the post-socialist countries where FDI was on a large scale and flowed into the manufacturing industry and where the contribution of the large corporate sector to GDP matches or exceeds the EU average, it was possible in Slovakia only to reduce the productivity gap between the SME sector and the large corporations to the level of the North-Western member states. The reason why a far weaker performance is shown in Slovakia at the level of the medium-sized corporations cannot be deduced from the statistical data. Estonia and Latvia lack an FDI-based large corporate sector similar to that of the Visegrád states, which is also related to the small size of the former two countries.

Overall, the development model of the CEE countries undoubtedly led to successes. If, from the period after the transformational recession, we treat 1995 as the baseline (this, importantly, being the first available data in the Eurostat database) and compare this with the year before the crisis, then in terms both of GDP and of final consumption, which better expresses the prosperity of the population, with the exception of the two richest states, the Czech Republic and Slovenia, a growth of 10–30 percentage points could be observed. A comparison with the 1989 baseline could also be made, but due both to the quality of the statistical data from that time and to the quality of the commodities making up GDP back then, this comparison is suitable only as a very approximate guide (Table 4.2).

However, it is also clear from the foregoing that the features of the current CEE model do not support the thinking that prevails in the EU doc-

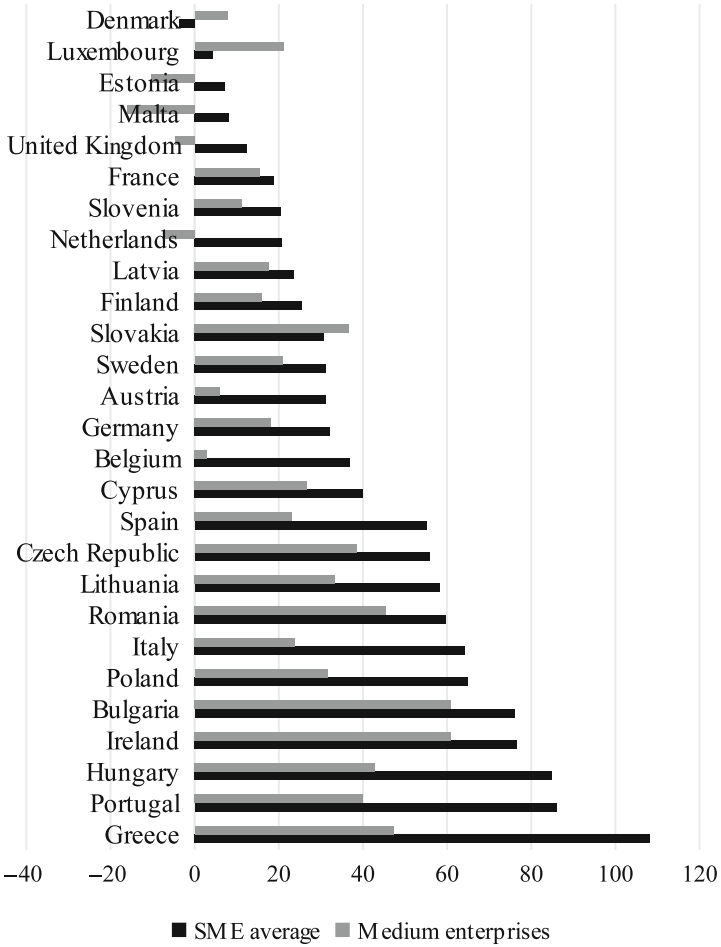

Fig. 4.1 Difference in labour productivity between large and medium-sized enterprises and between large companies and the SME sector, relative to the average for the whole economy, as percentage points, in 2007. *Source*: Author's calculation based on Wymenga et al. (2011). *Note*: Labour productivity is measured in terms of gross added value per employed person

uments (for example, the Commission report discussed above), namely, that the new, post-socialist member states are on a growth path that only from the OMS differs in quantitative terms and that convergence is only a matter of time. We can realistically define the current position

Table 4.2 Convergence of the post-socialist countries in terms of per-capita GDP and per-capita actual individual final consumption, at PPP, compared to the EU-27 average and to the GDP of 1989

	Estonia	Latvia	Lithuania	Poland	Czech Republic	Slovakia	Hungary	Slovenia	Romania	Bulgaria
Per-capita GDP, EU-27 = 100										
1995	36	31	35	43	77	47	51	74	33	32
2007	70	56	59	54	83	68	62	88	42	40
Per-capita final consumption, EU-27 = 100										
1995	36	34	38	44	68	38	49	75	35	35
2007	64	56	63	55	69	63	59	80	45	44
Per-capita GDP, 1989 = 100										
2007	150	124	116	169	139	154	135	151	120	107

Source: AMECO, Eurostat, EBRD (2008: 13)

Note: Actual individual final consumption is equal to expenditures on the consumption of goods and services by households and non-profit institutions serving households and in-kind social transfers

and future growth of the NMS by applying Porter's (1998) competitive advantage theory presented in Part I. To use Porter's terminology, the CEE economies are in the factor-driven stage because we have to classify them on the basis of the home-based economy.[16]

On the basis of Porter's (1998) theory, for the transition to long-term convergence and the innovation-driven stage—which was the goal of the EU's Lisbon Strategy and, later, the Europe 2020 strategy—FDI, the presence of foreign multinational corporations is necessary, but not in itself sufficient. Multinational corporations position their activities, which are present in the various phases of the value chain, in the various countries in accordance with their global strategy. In other words, the domestic base, as described above, remains in the home country in which the company has its seat. An emerging economy that bases its strategy only on multinational corporations could be destined to remain a factor-driven economy. In certain phases of development, the focus of economic policy must shift towards indigenous corporations.

In other words, the economic policy framework that the EU tends to designate (for example, in the study quoted several times above, ensuring macroeconomic stability, a sustainable balance of payments, effective use of subsidies from EU funds, and so on) is necessary, but not in itself sufficient to ensure that the NMS progress in the direction of convergence in the long term. The present institutional frameworks are adequate only for a growth path that perpetuates asymmetric mutual dependency between the OMS and NMS. The most important promise of the change in the political system was that the CEE countries, which were left out of the mainstream of development after the WWII, could converge with the more fortunate western countries within a historically foreseeable time frame.

The task of economics and political economy is to answer the question of what path can be taken by the NMS towards an innovation-driven, home-based economy. Among the countries that converged only very late, after WWII, only Finland shows convincing evidence that it has succeeded in entering this stage. Finland, however, had a means of travelling the path from the factor-driven economy to the innovation-driven economy. The global economic environment of the time made it possible, during the investment-driven stage, for the state—partly through

its ownership of large corporations—to play a key role in the modernisation process, and the source of capital accumulation was chiefly national capital. Even still, we are only talking about economic factors, and we have not gone into detail regarding the differences in terms of social capital relative to the CEE countries.[17]

If one aims to maintain convergence as a defining element of the system of economic policy targets of the post-socialist member states, a way to supplement the FDI-based model in the current stage of global economic and EU integration with a set of tools that facilitate the development of a innovation-driven, home-based economy in the original Porterian sense must be found. Additionally, all this should be achieved by building on genuinely extant social institutions, norms and attitudes and genuinely extant social capital.

If the 2008 crisis had not occurred, then due to the low income levels of the post-socialist countries, these questions might have remained theoretical for a long time, and the present model could have assured growth potential for a long time to come. The Czech Republic and Slovenia might have been the experimental countries that either became stuck at the current level[18] or were capable of joining the core countries. The crisis, however, is transforming the entire landscape of the global economy, and the development opportunities available to the CEE member states need to be reassessed in this light, as does the question of whether, in the wake of the crisis, the individual countries in the region have embarked on differing paths of development or whether they can still be interpreted in the framework of a single model.

Notes

1. The number of clusters, based on Akaike's information criterion and its relative change, is almost always two.
2. The single cluster of new member states would have broken up only in the seven-cluster version, without any definitive economic explanation.
3. The Swedish reforms are discussed in detail by Freeman et al. (2010), the Danish reforms by J. G. Andersen (2011).
4. The authors' subtitle—Can the Bumblebee Keep Flying?—indicates that we are dealing here with something of a curiosity compared to the eco-

nomic mainstream. The analogy was borrowed from the Swedish prime minister. In theory, bumblebees should not be able to fly, given their large bodies and tiny wings. The IMF's meticulous authors restore the scientific world order at the end of their work, referring to a study in which physicists explain how such flight is indeed possible.

5. Hereinafter, the Eurostat on-line database (http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/themes) is referred to as "Eurostat".
6. When analysing social protection, it has been indicated that the process of liberalisation was not complete even at this time; due to political resistance, the Thatcher government stepped back from privatising the National Health Service (Pierson 1996).
7. Kirby (2010) provides a wide-ranging survey of the literature on Ireland's economic development.
8. A 30 per cent threshold was determined necessary for initiating a mandatory takeover offer (Houwing and Vandaele 2011: 130).
9. It is an interesting comparison that the community support provided to Spain—not including the agricultural fund—between 1986 and 2006 accounted for three times as much as the amount of the Marshall Plan (Royo 2008: 48).
10. http://estonia.eu/about-estonia/society/citizenship.html, date accessed 23 February 2015
11. For a related analysis of the Estonian Research and Development Council, see Tiitset al. (2003).
12. http://www.bbc.com/news/world-europe-17083397 date accessed 25 February 2012.
13. There are significant differences in GDP data among the sources. The data in this study are based on the Report of EBRD from 1999, on the one hand, because this organisation specialises in the research of this region and, on the other hand, by that time, corrections had been made. It is especially important to note because according to Mygind (1997: 58–59), on the basis of earlier EBRD data, the decline was more than ten percentage points greater in case of Estonia and Lithuania. These years are not included in the online database of Eurostat.
14. The public debt of all of Yugoslavia was 15.99 billion USD at the end of 1991, and the part controlled by the federation (one-third) was distributed in the agreement on succession issues. The successor states began negotiations with the international organisations and the "Paris Club" creditors. Negotiations had been conducted since 1988 with the "London Club" (which included the private creditors) about debt restructuring processes,

and as a result, by mid-1993, the debt of 7.3 billion USD shrank to 4.3 billion USD. This result was greatly facilitated by the fact that the Yugoslavian government bonds were purchased for 20 per cent of their book value on the secondary market; thus, basically, the states themselves acquired their own debt (Stanič 2001: 758–761).

15. Please note that for those Romanians who belong to the Romanian Orthodox Church, the day of the execution was an ordinary day, not Christmas day.
16. The competitiveness report of the World Economic Forum places these countries higher in the classification—with the exception of Bulgaria—and these countries are in the innovation-driven stage or are on their way there, that is, in a transition phase (Schwab 2009). However, in the report, the aspects of the assessment broke away entirely from the original theory of Porter (1998); the basis of comparison was per capita GDP compared at market rate and the exports of mineral products as a share of overall exports. In this study, in assessing the prospect of the CEE model, Porter's aspects are more relevant; therefore, these aspects will be reviewed.
17. The survey of Eurobarometer in 2004 reveals the differences in social capital among the member states rather well (Eurobarometer2005).
18. The Czech Republic has not been able catch up as far as final consumption is concerned since 1995 (Table 4.2); the structural problems that were hiding behind Slovenia's spectacular economic performance would have spoiled the achieved consumption level anyhow, even without the crisis.

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Part III

Market Economies of the EU in the 2008 Global Crisis

Regarding what institutional studies forecast about the performance of individual models during the crisis, the greatest vulnerability was shown by the institutional systems of the Mediterranean countries and the CEE countries. At the same time, in terms of the driving factors, the severity and persistent effects of the crisis, some of those areas of the institutional system that were not considered significant in the market economic modelling in the VoC literature (for example, the sectoral structure of the economy and FDI and an exchange rate regime outside the euro area) have been given emphasis. Therefore, it is informative, from an institutional point of view, to have an overview of the driving factors of the crisis in the various European models. The processing of institutional changes in the literature has not been performed entirely, so I have to rely largely on the analyses of the European Commission and the OECD. In the interest of transparency and better understanding, the characteristics of the models and the changes are summarised in respective tables (Tables 5.2, 6.2, 6.5, 7.3, 8.2, 8.4, and 8.6). In case of the changes, not only obvious institutional changes have been taken into account but also regulatory changes; it cannot be determined whether these changes are parametric or whether they will change the institution over time. Within the models of capitalism, if a distinction is made between subgroups (in the case of the North-Western countries and the CEE countries), I make

the comparison on the basis of the subgroups, taking their characteristic features from before 2008 into consideration. In Part III, statistical data are taken from the Eurostat database on several occasions, but constant reference to Eurostat would significantly deteriorate readability. The online Eurostat database has been used in all cases where the data source does not indicate otherwise.[1] Data for the coming 2–3 years are taken from the autumn forecast (2014) of the European Commission available at the time the manuscript was completed (European Commission 2014a).

Note

1. Data from the Eurostat online database downloaded on 11 January 2015 are used in the case of real GDP growth rates, the 5-year change in the share of world exports, general government gross debt, general government deficit/surplus, consolidated and non-consolidated private sector debt as a percentage of GDP, housing price indexes, rates of those at risk of poverty after and before social transfers as a percentage of the total population, severely materially deprived people as a percentage of the total population, people at risk of poverty or social exclusion as a percentage of the total population (EU2020 poverty indicator), the GINI coefficient of equalised disposable income, and the income quintile share ratio (S80/S20). Data downloaded on 22 January 2015 are used in the case of the balance of the current account as a percentage of GDP, the 1-year percentage change in export market shares, high-tech exports as a percentage of exports, unemployment rates (aged 15–74, less than 25 years), employment rates (aged 20–64), unit labour costs for the whole economy, and real effective exchange rates for 42 trading partners.

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5

Crisis-Resistant Nordic Countries?

In my cluster analysis, Denmark is considered a borderline case between the Nordic and the continental European countries. Because Denmark manifests the characteristic features of the Nordic countries in exactly those subgroups in which the OMS differ the most (labour market and social services), I include Denmark among the Nordic countries. In 2009, the Nordic countries suffered a decline that extended beyond the EU average (–4.4 per cent); Finland experienced the greatest depression. The Swedish and the Finnish economies recovered rapidly and considerably exceeded the growth rate of the EU-28 in 2010 and 2011 (2.1 and 1.7 per cent, respectively). When 2012 brought a 0.4 per cent downturn to the entire EU, only Sweden was able to avoid recession and only the Swedish economy was likely to achieve significant growth in the coming years. As far as unemployment is concerned, all three countries perform better than the EU average (Table 5.1).

If we study the processes of the last half decade in greater depth, it becomes clear that not only the short-term prospects show the more beneficial situation of *Sweden*. By the time the global crisis hit the Swedish economy, the far-reaching results of the reforms made in the 1990s could be felt and detected in persistent growth, increased employment, stable

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Table 5.1 Some of the major macroeconomic indicators of the Nordic countries 2004–2013

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment—volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T−1	Nominal unit labour cost index(2010 = 100)—percentage change T/T−1
Denmark								
2004–2008 average	1.8	4.3	3.7	35.1	198.4	2.9	0.2	3.1
2009	−5.1	6.0	−15.9	40.4	233.3	3.4	2.6	5.1
2010	1.6	7.5	−4.0	42.9	222.1	5.8	−4.4	−0.8
2011	1.2	7.6	0.3	46.4	222.6	5.9	−0.7	0.2
2012	−0.7	7.5	0.6	45.6	226.7	6.0	−2.9	1.9
2013	−0.5	7.0	0.9	45.0	223.2	7.3	1.0	1.9
Finland								
2004–2008 average	3.4	7.6	4.0	39.0	118.4	4.3	−0.8	1.9
2009	−8.3	8.2	−13.2	41.7	141.3	1.8	3.1	8.5
2010	3.0	8.4	1.1	47.1	145.8	1.5	−5.7	−1.4
2011	2.6	7.8	4.1	48.5	142.4	−1.5	−0.1	2.3
2012	−1.5	7.7	−2.5	53	147.1	−1.4	−2.6	5.2
2013	−1.2	8.2	−4.8	56	146.6	−1.1	2.9	1.9
Sweden								
2004–2008 average	2.9	6.9	6.6	45	169.7	7.8	−1.0	1.2
2009	−5.2	8.3	−15.5	40.3	212.6	6.2	−7.3	5.7
2010	6.0	8.6	6.0	36.7	200.8	6.3	6.5	−2.6
2011	2.7	7.8	5.7	36.1	200.3	6.1	4.1	2.6
2012	−0.3	8	−0.2	36.4	202.3	6.0	−0.8	4.1
2013	1.3	8	−0.4	38.6	200.1	6.2	1.7	1.3

Source: European Commission (2013a), Eurostat

public finances, and impressive places in international competitiveness rankings. This advantageous starting position made it possible for Sweden to pursue counter-cyclical economic policy. Recovery was facilitated in 2009 by currency devaluation, interest rate reduction and fiscal incentives amounting to 1¾ per cent of GDP (road and railroad investments with labour market packages). Due to the strict fiscal policy of earlier years, in spite of the economic recovery measures, Sweden's deficit was only 1.3 per cent in 2013, when it hit the deepest point and the structural deficit of the budget did not rise above 1 per cent, either. In order to maintain fiscal discipline, in 2011, the fiscal policy framework was renewed, containing a top-down budget process where the expenditure ceiling is established first and then the government allocates expenditures within this limit to individual budget areas (Bergman 2011).

The Swedish banking system pulled through the 2008–2009 crisis years relatively well. The state aid provided for the recapitalisation of banks, and asset relief interventions between 2008 and 2012 was only 0.2 per cent of the 2012 GDP. Although in the Nordic countries—as we have seen above—the role of the financial markets increased, the Swedish banking system is large relative to GDP, and the banking sector assets amount to four times the GDP[1]; at the same time, the system is rather concentrated because four banks dominate the market. Foreign credit exposure accounted for 158 per cent of GDP in 2013 after deleveraging in the Baltic states. The exposure of the Swedish banks to those countries affected by the crisis of the euro area is insignificant, and towards the Baltic states, credit exposure is 10 per cent of the GDP. A risk factor is that deposits constituted only 40 per cent of the total funding in 2013, and half of the wholesale market funding instruments was short term for years; only in 2013 did the share of long-term funding increase significantly. At the same time, it is very favourable that capital adequacy ratio is well above the Basel III requirements and that the authorities made several of the elements of the banking regulations stricter. State guarantees in 2012 were 1.1 per cent of the GDP (4.87 per cent in the 2009 peak year), which means that bank restructuring costs were low, compared to the other countries in Europe (European Commission 2014g; ECFIN DG 2014o: 51–56).

That the banking system did not experience greater difficulties was closely related to the fact that the overheated property market fortunately did not collapse, as it had in other countries. The increase in house prices began as early as 15 years before the crisis. Demand was increased by the growing income, low interest rates on mortgage and low property taxes, while high construction costs, weak competition in the construction sector, shortage of land for construction due to the planning and zoning processes, and long procedures for building permits all limited the supply, subsequently leading to high housing prices. The low interest rate environment, expansive monetary policy, income tax cuts, the reduction of property taxes, and the rapid revival of economic growth were able to prevent a drop in housing prices. Nevertheless, the housing market remained a risk factor together with the great extent of indebtedness of households. The non-consolidated debt of the private sector is approximately 240 per cent of the GDP, which is well over the EU threshold of 160 per cent, which is the reference value for the macroeconomic imbalance procedure of the EU. Household indebtedness (80 per cent of GDP) is the more dangerous of the two because a considerable part of corporate debt (50 per cent of GDP) originates from cross-border intra-company loans usually serving the purpose of tax minimisation between countries (ECFIN DG 2014o: 30–32, 39–49).

The competitiveness of Sweden remained strong even during the crisis years, which is demonstrated by the fact that it has an on-going current account surplus. Neither the unit labour cost (ULC) nor the evolution of the real effective exchange rate (REER) indicates that Sweden would be at a disadvantage in terms of cost competitiveness. According to the analysts of the European Commission, there are no imbalances behind the persistent Swedish surplus and this surplus is not fed by the artificially constrained internal demand, but it rather offsets the severe deficits originating from the 1990s. At the same time, further corrections can be expected. Nevertheless, even after the correction, a sustainable, close-to-balance surplus can be forecast (ECFIN DG 2013f).

Naturally, due to the crisis, Swedish exports had to confront great difficulties because more than half of its products are transported to the EU countries, and in 2012, the Swedish krona (SEK) appreciated. Swedish exports are strongly diversified, but certain traditional products (paper

and pulp products, sawn goods, motor vehicles, telecommunication products, and so on) face persistently decreasing demand. Therefore, due to these factors, the country suffered losses on the export market—14.9 per cent during five years before 2013—but without the increasing market share on the services market, such losses would have been greater. Services currently account for one-third of exports, and their significance is increasing. Services are becoming integrated into industrial activities, and the borderline between the two is often blurred (for example, in logistics). In Sweden, where deindustrialisation did not take place in the same manner as it did in other developed countries and where industry still provides one-third of output, this intertwining is especially significant. Knowledge-intensive business services are actually considered the engine of growth. Competitiveness maintained against the difficult external circumstances was complemented by the fact that competition was not weakened, even in the years of the crisis. Sweden was one of those member states that integrated the EU directive on the liberalisation of services before the deadline. The OECD indicators of product market regulation in 2010 showed better values for Sweden than the OECD average (OECD 2013i).[2]

Sweden still tops the EU innovation ranking; the years of the crisis did not change its top position. At the same time, such processes began—rather due to the globalisation than the crisis—which raised anxiety in the Swedish experts. Sweden is often labelled as a headquarter economy because a large number of multinational companies are present in the Swedish economy relative to the size of the country and their presence is maintained not by the subsidiaries but by the headquarters. However, after the liberalisation in the 1990s, the proportion of foreign ownership has grown through mergers and acquisitions, for example, in the automotive and pharmaceutical industries. The state authorities and the local governments did their best to save some of the outstanding brands of high quality—in vain—because in the international market, they could not offset their disadvantage, which resulted from the small size of the country. Until now, this has not been seen as a huge loss because the companies in which the majority of shareholders were foreign have spent large amounts of money on R&D. However, between 2005 and 2009, the R&D expenditure of foreign-owned companies decreased from SEK

32.9 billion to SEK 23.2 billion, while that of domestic-owned companies increased from SEK 40.4 billion to SEK 44.5 billion. Moreover, the foreign R&D expenditure of the 20 largest Swedish-owned companies increased more quickly in the developed countries than in Sweden; furthermore, outsourcing the R&D activity to low-income but rapidly growing countries began as well. Expenditures of R&D are concentrated, large corporations (with 250 or more employees) spend more than 80 per cent of expenditures (which is not striking in Europe), and three-quarters of expenditures are related to five large corporations (which is not an outstanding proportion among the small European countries). A survey was performed in which information was gathered about what the large corporations plan to do in the coming five years. Their replies reveal that 60 per cent do not plan to decrease their R&D expenditures; moreover, they wish to increase these expenditures even further. Among the companies that intend to increase their R&D expenditures, the proportion of Swedish-owned companies was higher than foreign-owned ones. Nevertheless, in Swedish innovation policy, the consequence was drawn: these companies should not concentrate on one of the segments (small or large enterprises, domestic or foreign, and so on), but the whole business environment must be made attractive in order to retain or encourage R&D in the rapidly integrating international economy (Swedish Agency for Growth Policy Analysis 2011: 68–71, 84–85).

Swedish employment began to improve quickly after the decline caused by the crisis; in 2012, the unemployment rate was 8 per cent, and the employment rate in the age group between 20 and 64 was 79.4 per cent, but this rate could not reach the pre-crisis level. The favourable performance of the labour market is closely related to the reforms of the previous period. The flexible product market, the introduction of a tax system and a system of unemployment benefits, which intensified job-search activities, both shortened the length of unemployment, even during the years of the crisis, and protected people from persistent unemployment. These factors were complemented by the consensus-oriented dialogue between the social partners and the flexible wage agreements that adapted to the economic cycle. Trade union density was still very high, approximately 70 per cent, and in spite of the decentralisation tendencies, the sectoral level remained dominant. The collective agreement for 2010–2012 cov-

ered 88 per cent of employees. The government also introduced a complex labour market package, which included several areas from job-search incentives, through reducing the tax on labour income and supporting job creation to increasing the number of admitted students to higher education and vocational training. The government wanted to prevent what happened at the beginning of the crisis in the 1990s, when employment could not return to the pre-crisis level. In order to do so, the experts deemed it necessary to introduce further reforms as well (for example, approximating the employment protection regulations of the employees with fixed-term contracts and with open-ended contracts); however, the most critical issue seems to be the employment of unskilled young people and non-EU immigrants (Harbo Hansen 2011: 7–10; Eurofound 2014). The severity of the problem is presented well by the fact that youth unemployment remained 23.6 per cent in 2013, which is strikingly high, even if we consider that an age bracket containing a considerable number of people entered the labour market and that half of the jobseekers are university students. The increase in both youth and overall unemployment could have also occurred because Swedish economic policy traditionally does not strive to maintain the level of employment at a time of decline or structural change. In contrast to France or Germany, in Sweden, the labour force was not maintained by reducing working hours. Redundancies in Sweden affected primarily the more vulnerable groups (Anxo 2012; EC SWD 2014i: 18). From the viewpoint of transition from school to work, a warning sign for the future is that PISA results in 2012 show below-average performance, while the public expenditure on education was high, amounting to 6.8–7 per cent of GDP (OECD 2013j: 5, 2014b: 258).

The crisis did not bring substantive change to Swedish social policy; the necessary steps for the sustainable pension scheme had been made earlier. Social disparities are still among the lowest. At the same time, they have been increasing dynamically since the 1990s as a result of the increasing inequality in market income and the concentration of income from capital. The increase in income disparities did not stop in the years of the crisis (Table A.8).

Among the three Nordic countries, *Finland's* economy suffered most from the decline in 2009, shrinking by –8.3 per cent. In the subsequent

two years, it seemed that the growth rates recovered rapidly, but in 2012, the economy entered a recession again, and the prospects in terms of growth for the coming years are gloomy. Nevertheless, according to the 2014–2015 Global Competitiveness Index, Finland is the fourth most competitive economy in the world (Schwab 2014: 13). As shown below, this outstandingly positive evaluation is not confirmed by either the European Commission, the OECD, or the analyses made by Finnish experts. The crisis at the beginning of the 1990s was followed by reforms in Finland as well, and similar to Sweden, Finland also began a successful development path. Nevertheless, the 2008 crisis revealed structural problems, which meant that the Finnish had to face difficulties that were greater than those faced by Sweden.

What made the 2009 decline even more serious was that the export decreased by one-third partly because 80 per cent of the exported goods were investment and intermediate products, the demand for which is sensitive to fluctuations in the business cycles. Moreover, the Russian market has played an important role in Finnish exports, and the decline was also strikingly dramatic in Russia. Due to its strict fiscal policy, Finland had reserves; therefore, the missing export demand was compensated by fiscal incentives, which amounted to 1.8 per cent and 1.5 per cent of GDP in 2009–2010. The size and means of the fiscal package (tax reduction and support for the unemployed and local governments) did not differ from the practice usually applied by other countries, but its structure did. Only one-third of the measures were one-time, and the others did not have a definite ending date; consequently, their survival would make the budget unsustainable, the stability of which is jeopardised anyway by those costs caused by the ageing society and that actually exceed those of the other developed countries. Since 2013, Finland has been trying to gradually terminate the fiscal incentives by tax increases and expenditure ceilings, but due to the weak growth prospects, this is not entirely without risks, either. As the result of insufficient budget revenue, the stabilisation of the budget must be continued with expenditure cuts, and in spite of the less than 3 per cent deficit, the public debt is slowly approaching the Maastricht criteria of 60 per cent, probably exceeding it in 2015.

In Finland, the financial crisis did not affect the banking system; the banks were well-capitalised and remained profitable, and they were not

exposed to the economies in trouble. This does not mean that there are no risks. The banking system is very concentrated, Nordea Bank Finland, the subsidiary of the Swedish Nordea group, holds two-thirds of the total assets. The growth of the financial sector liabilities resulted mainly from the increase in foreign (Swedish, Norwegian, Danish, and English) deposits and wholesale funding, which makes the banking system vulnerable. The situation in the housing market is a risk factor as well, although to a decreasing extent. The real prices of housing have been increasing dynamically since the beginning of the 1990s and by 92 per cent between 1993 and 2007. The increase in demand was facilitated by high loan-to-value ratios for first-time buyers, tax deductibility of mortgage interest payments and low property taxation. In 2009 there was a risk that after the transitional decrease in demand—given the low mortgage interest rates; the real estate bubble may have developed, but the Finnish Financial Supervisory Authority managed to stop the process with the help of its 2010 guidelines. The tax deductibility of mortgage interest payments will be gradually phased out. New construction activities have decreased since the beginning of the crisis. Altogether, it can be expected that the housing market will stabilise. The indebtedness of the private sector grew during the crisis, but it does not seem risky either in the case of households or in the case of companies (ECFIN DG 2013d: 17–18, 33).

In Finland, labour productivity increased by an average of 2.8 per cent annually between 1991 and 2008, which means that Finland managed to catch up with the top-performing countries in the world. Finland's external positions were strong, and the country repeatedly ran current account surpluses. Catching up in terms of labour productivity came to a halt in 2008–2009, the current account turned negative in 2011, and the deficit of 1.8 per cent grew further, reaching 1.9 per cent in 2012. In the five years preceding 2013, Finland suffered a 32.2 per cent loss in export market share for several reasons.

It affected cost competitiveness unfavourably that while wage growth had always been in line with the increase in productivity, after the wage agreement in 2007—in which the crisis were not yet taken into account—ULC increased more suddenly than its main competitors. Wage negotiations were decentralised in 2007–2008, but the expected system, which would flexibly adapt to the market changes, did not emerge; therefore, in

2011, a new centralised national agreement was made between the social partners. In the wage agreements that have been concluded since, wage growth has already been contained. The evolution of the wages did not have a primary role in the evolution of competitiveness, and the increase in energy costs played at least as important a role in the increase of costs. The companies maintained their cost competitiveness by profit reduction, which, on the other hand, reduces their investment possibilities. Nevertheless, as for the future, cost items remain important because production began to shift from high-tech products to more price-sensitive intermediate products (ECFIN DG 2014e).

Among the reasons for the loss of market share, non-price competitiveness factors weigh more. The geographic distribution of exports was markedly unfavourable before the crisis, and, among its competitors, Finland exported relatively the most to the fast-growing Brasilia, Russia, India, and China (BRIC countries), but during the crisis Finland lost market shares as well. One of the reasons for this can be found in the product structure. Losing market shares in the case of electronic products and products of the forestry and paper industries began as early as the beginning of the 2000s. The export performance in machinery, the chemical industry and the metallurgical industry began to improve after 2010, but this improvement was not enough to offset the losses suffered by the above-mentioned industries, similarly to the trade balance of services, which moved within a range of +/−1 per cent in the last decade. The importance of the electronics industry is shown by the fact that at its highest peak, in 2000, it provided 11 per cent of Finnish added value, and half of the growth in added value could be attributed to this sector. At that time, the production of Nokia alone accounted for 4 per cent of GDP and contributed to the growth by 2 percentage points. By the end of 2012, Nokia had relocated its industrial production outside of Finland and exported services only, especially R&D. Half of the decline in Finnish GDP during the crisis could be attributed to the electronics industry (ECFIN DG 2013d: 23). The declining export performance is also explained by the fact that the number of exporting companies is low and the range of products they offer is limited. In 2012, 1 per cent of the Finnish exporting companies handled 76 per cent of gross exports, and small companies showed only faint willingness to export. The effect of

the non-tradable sectors also contributes to the problems of competitiveness because their current level of productivity falls substantially behind that of manufacturing. While in the product markets, the freedom of competition reached the level of the Nordic countries, competition pressure in commerce, public services, transport and communication services was weak, and the increase in labour costs began as a result (ECFIN DG 2014e: 35, 45).

Finland is steadily among the leading innovators within the EU. The restructuring of the information technology sector and its expectedly persistent shrinkage caused difficulties for Finland in keeping its leading position. This sector is—by nature—R&D intensive, which explains why the R&D expenditures of the private sector in Finland account for almost 3 per cent of GDP. Nokia alone financed approximately 30 per cent of the R&D expenditures. At the same time—contrary to the case in Sweden—the R&D intensity of the other industries is not too high in Finland. The state has borne only one quarter of the R&D expenditures so far. In 2012, both the private sector and the state decreased their R&D expenditures, from 3.80 per cent of the previous year to 3.55 per cent of GDP, which is—naturally—still an outstanding value. The critical issue is the efficiency of the Finnish research and innovation system in turning investment in R&D into new innovative products and services. Another challenge Finland must face is that, thanks to the successful convergence of the previous period, a substantial part of the industry is running close to its technological frontier, which means that any step further is possible only by way of innovating new products and processes (OECD 2012b: 44; EC SWD 2014o: 21).

The Finnish labour market functioned very well before the crisis, but the level of employment was lower than that of the other two Nordic countries. The level was lower in case of the young, the elderly and women of child-rearing age, which was reflected in the low prevalence of part-time work. In response to the crisis, unemployment did not increase as dramatically as GDP plummeted. One of the reasons for this was that the temporary layoff of employees was possible and that these employees could be reemployed when the economy started to recover without the cost of recruiting new employees. After the decline in 2009, recovery of the economy was due largely to the fiscal stimulus package and the mone-

tary easing of the ECB, but after this temporary effect, the labour market stagnated, and the unemployment rate was around 8 per cent. In establishing the system of flexicurity, Finland did not go as far as its Nordic neighbours; thus, introducing unemployment benefits that are intensify job-search activities remains to be done, as does the extension of active labour market policy programmes. The actual age of retirement increased (by 0.8 year between 2008 and 2013), but it may decrease again due to the recession and sluggish growth; however, it would be important to keep the employees in the labour market for a longer period of time because of the ageing of society. The old-age dependency ratio is 26 per cent in Finland, which is well above the OECD average (19 per cent). The pension reform in 2005 did not bring such radical changes as in Sweden, and early retirement was still widely available; however, this reform is not sustainable within the given demographic circumstances, and the restriction of disability pensions cannot be avoided, either (Braconier 2010: 5, 18).

The education system in Finland is still among the best in the world, according to the latest PISA report, although a minor decline can be seen compared to the previous report. During the crisis, public spending on education maintained its high share (above 6 per cent of GDP), but because of the further budgetary consolidation, a significant, 300-million-euro decrease can be expected (OECD 2013j: 5, 2014b: 258; EC SWD 2014o: 17).

As far as income inequalities are concerned, the same can be reported about Finland as about Sweden. Compared to the EU member states or the OECD states, Finland is among the countries with the lowest inequality indicators, but since the beginning of the 1990s, inequalities have increased a great deal. The reasons are similar: the differences between the factor incomes have increased (the share of labour income has declined) and welfare provision has decreased. Given the increasing inequalities, it is important that the income of highest earners has dynamically risen and that the regional labour outcome disparities have increased (OECD 2010b).

Denmark achieved steady growth of approximately 2 per cent in the decade preceding the crisis, which fell behind the growth dynamics of the other two Nordic countries. In 2006 and 2007, this growth was based on credit expansion and a bulging housing bubble. The crisis resulted in a

5.1 per cent decline in GDP, which was accompanied by a 20 per cent—calculated in real terms—decrease in housing prices. The year 2010 saw some improvement due to the fiscal stimulus measures and the more favourable export opportunities, but in 2012, another recession took place—similarly to the euro area (ECFIN DG 2013c: 11). The Danish government did not give up its disciplined fiscal policy, which was also characteristic of the other two Nordic countries. Government deficit hit its deepest point in 2012, with 3.9 per cent, and public debt remained at the level of approximately 45 per cent, even in the years of the crisis.

By contrast, the indebtedness of the private sector (230 per cent of GDP) in the case of Denmark exceeds by far the reference value of the EU for non-consolidated debt (160 per cent), and the corporate sector accounts for only approximately 100 per cent of this. The substantial indebtedness of the households presents a serious risk. However, it must be noted that the savings of Danish households are also larger than in other countries. Due to the introduction of the compulsory private pension scheme, 11 per cent of wages are collected for this purpose; thus, the net financial wealth of households has accounted for 50–100 per cent of the GDP since the mid-1990s. At the same time, private pension schemes and real estate are considered illiquid assets; thus, they decrease the risk of indebtedness slightly and the authorities attempt to prevent any further increases in indebtedness by making mortgage lending stricter. The bursting of the real estate bubble weighed heavily on the banking sector, which was otherwise less exposed to the South European economies. The size of the banking sector relative to GDP is huge, the amount of its assets are more than four times greater. The government had no alternative but to accept the introduction of bank rescue packages, and the cost of the recapitalisation of the banks between 2008 and 2012 accounted for 4.4 per cent of the 2012 GDP. As the result of the crisis and the new regulatory requirements, the banking system became somewhat more concentrated by way of resolutions and mergers and the financial supervision has been strengthened (ECFIN DG 2013c: 14, 2014d: 23–24; European Commission 2014g).

In 2013 and 2014, in the innovation scoreboard of the EU, Denmark entered the group of innovation leaders as the fourth in addition to the big three of Sweden, Germany, and Finland (European Commission

2013b: 5, 2014c: 5). Nevertheless, similarly to Finland, Denmark also had problems in terms of competitiveness. Denmark's current account remained in the positive even during the years of the crisis, but between 2008 and 2013, it suffered a 17.9 per cent loss in export market shares. Although in 2011, some improvement was experienced, the old problem remained: Denmark maintained its position in the traditional markets, but new export possibilities opened up in markets to which Denmark had never exported. This means that the geographic specialisation, which was a positive factor before the crisis, became a negative one. In Denmark, the large share of the SME sector in the corporate structure is greater than in Sweden or in Finland, which makes it more difficult for Denmark to make an appearance in the market of the BRIC countries. The product structure of Danish exports has been found to be favourable during the crisis from the viewpoint that the products of the pharmaceutical industry and food industry react less sensitively to cyclic changes. In recent decades, the product structure shifted towards high-tech products, but due to the strong food industry exports, the proportion of the low-tech products is still higher. It must also be added that within this product category, exports are concentrated in the higher-value segment. The problems of Danish competitiveness are found in the decline of cost competitiveness and in the slow growth of productivity rather than in the geographic distribution. In the last decade, ULC increased more than that of its main competitors, and its correction took place as the result of the crisis. In addition to wage increases, the fact that Denmark participates in the Exchange Rate Mechanism (ERM) II has contributed to the increase in ULC because, between 2000 and 2009, the Danish krone appreciated along with the euro, relative to the currency of the trading partners. Denmark's rate of wage increase did not exceed that of Sweden, Finland or the Netherlands, but its rate of productivity growth was slower (ECFIN DG 2013c).

After the crisis hit the country, social partners agreed to reduce the wages, which improved competitiveness. In Denmark, trade union density steadily decreased, similarly to the other member states of the EU, but even in 2010, it was at two-thirds of the workforce. Decentralising wage negotiations fits into the EU trend, the loose national framework is filled with content by primarily sectoral and, second, corporate

agreements, which is known as centralised decentralisation (Eurofound 2014).

In its 2010 report on competitiveness, the Danish government provided the same reasons for the slow growth of productivity as the researchers of the OECD. Besides the large public sector and the private services sector, the part of the economy exposed to international competition is relatively small. Another probable reason—in addition to the insufficiency of competition—is that the great (relative to GDP) amount of expenditure on education is not proportionate to the performance of the educational system. Average PISA results are achieved when public spending on education is around 8 per cent. The most important tasks are to improve vocational training and to accelerate the process of receiving a degree. Utilisation and commercialisation of research results does not reach the expected level, given that public spending on R&D is quite high (Danish Government 2010; McGowan and Jamet 2012; OECD 2013j: 5, 2014b: 258).

The Danish labour market is operating in the internationally well-known system of flexicurity, which is based on the joint mechanism of flexible labour market regulation, generous unemployment benefits (especially in low-income cases), and the forceful application of active labour market policy. The 2008 crisis provides an opportunity to observe whether the system is able to return—relatively quickly—to the low level of unemployment after the economic decline. Persistently high unemployment makes it impossible to maintain the three labour market institutions jointly, and the system becomes inoperable. As a result of the crisis, the unemployment rate doubled from 3.4 per cent in 2008 to 7 per cent in 2013. The employment rate suffered a decrease of 4.1 percentage points during the same period, but the 75.6 per cent rate in 2013 is still decidedly higher than the EU average (68.4 per cent). The increase in unemployment exceeded that of the other two Nordic countries, but employment in Denmark before the crisis surpassed the level that would have been reasonable on the basis of output, and the first reaction to the crisis was redundancy. While in several countries, adaptation to the situation included reducing the working hours, in Denmark, adaptation manifested in reducing the number of employees. At the same time, the increase in unemployment was surpassed by the decline in employment.

There are several reasons for this. Before the crisis, the number of members of the unemployment insurance fund decreased, and those who were not insured do not appear in the unemployment statistics. As the result of the crisis, the enrolment ratio increased, and migrant workers began to leave the country. Although circumstances were unfavourable, the flexibility of the system remained, which is demonstrated well by the notion that the number of people entering and leaving the labour market remained high. Naturally, the rate of finding a job is more unfavourable than it was before the crisis, but time spent unemployed remained short. Even during the crisis, 60 per cent of the unemployed found work within 13 weeks, and 80 per cent of the unemployed found work within 26 weeks (Andersen 2012: 125, 129). Another sign of flexibility is that the unemployment rate for young workers is favourable compared to the international data; in 2013, it was 13 per cent. The current reforms aim to reduce disability pensions, integrating as many disabled people as possible in the labour market, phasing out early retirement options and employing workers with migrant backgrounds, that is, increasing job opportunities (EC SWD 2014d). All in all, the flexicurity system has coped with the crisis until now, but it is too early to decide whether, after the crisis, it will be successful in preventing persistently high unemployment in the long run (Table 5.2). The table summarises the complete chapter. Thus I refered to it in general in the intorduction of this Part.

After the five-year period of the crisis, the institutional systems of the Nordic countries do not show substantial changes compared to the model we have known until now. It is invariably characteristic of the Nordic model that economic growth is built on R&D&I, the necessary reform measures are brought about on the basis of cooperation among social partners, the level of employment is high, the role of the active labour market policy measures is important, strengthening competition is accompanied by a high level of social protection, and the fiscal policy of the state is disciplined. The crisis has drawn attention to the fact that although the Nordic model is usually characterised by the duality of intensive competition and extensive social protection, in reality, the competition in Denmark and Finland is strong in the tradable sectors. Although it is a general phenomenon in the market economies that there is a difference in the intensity of competition between the tradable and

Table 5.2 Changes in the institutional systems of the Nordic countries after 2008

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Before 2008						
Liberalised	Vanguard innovation system	In addition to bank-based financial system, the development of financial markets	Flexible labour market with active labour market policy	More decentralised than earlier, but extended collective agreements	High level of welfare provision is able to decrease social inequalities	High level of public spending on education, high level of participation in higher and adult education
Characteristic institutional and regulatory features after 2008						
Sweden						
Diversified structure of industry, industry-related, knowledge-intensive services	Decreasing business expenditures, outsourcing R&D	Stable banking system despite a great extent of foreign exposure	Risk of dual labour market, high rate of youth unemployment	Wage agreements are adjusting to the impacts of the crisis	No change in the universal welfare system	Declining performance in public education not in line with financing, below-average PISA results

(*continued*)

Table 5.2 (continued)

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Finland						
Few exporting large corporations with a modest variety of products, weak competition in the non-tradable sectors	Contraction of the ICT sector jeopardises the innovation system	Stable banking system, integrated into the Nordic (Swedish-Danish) bank group	Constraint for the further liberalisation of the labour market	Agreements for wage moderation	Due to outstandingly large burden of ageing, entitlement rules concerning old age and disability pensions are gradually tightened	Above-average, slightly declining PISA results
Denmark						
Large SME sector has difficulties entering the market of the emerging countries, weak competition in the non-tradable sectors	Utilisation and commercialisation of research results insufficient relative to high R&D expenditure	Burst of the real estate bubble weighing heavily on the banking system, regulation becoming stricter	Flexicurity system is functional	Agreements for wage moderation	Restraining early retirement and disability pensions to stimulate labour supply	Performance in public education not in line with financing, average PISA results

Source: Author's compilation

non-tradable sectors, the extent of this difference in the two countries weakens the competitiveness of the entire economy.

Among the three countries, Sweden was the most successful in pulling through the hard times of the crisis, the country where the characteristics of the Nordic model manifest the most clearly and where the most consistent reforms were carried out in the previous one and a half decades. Naturally, these small, open economies cannot isolate themselves from their economic environment, the EU and especially from the impacts of the crisis phenomena of the euro area, which restrict their possibilities for growth. The perspective of the model is deteriorated and/or jeopardised by another factor—besides the external economic environment—that is, the ageing of society. Competition, which is strengthening due to globalisation, and the related increase in terms of social inequality did not come to a halt, which may undermine one of the most important "trademarks" of the model. Schnyder (2012)—in connection with Sweden—draws our attention to the fact that the high level of employment can be maintained only by badly paid jobs created in private households (clearing, maintenance jobs, and so on), and as a consequence, it may happen that certain social groups (especially immigrants or women) may get stuck in these. Thus, segregation of the labour market appears here as well, as confirmed by Anxo (2012). If this segregation is maintained, it would destroy the egalitarian Nordic system. It is very instructive to compare these two approaches because it indicates the same facts are interpreted differently by the authors, that is, the values and the preconception of the author cannot be eliminated from the process of interpretation. While Schnyder places emphasis on the integration of the neoliberal elements and the gradual breaking down of the Swedish (Nordic) model, Anxo places emphasis on the survival of the institutional characteristics. Anxo points out that, even with the right-wing government, the power structure remained balanced among the social partners; therefore, the cost of the crisis was shared. Changing the taxation and the welfare system in order to strengthen work incentives meets the characteristic features of the original Swedish model, which has always given work preference over passive support.

During the crisis, factors that are usually not covered by the comparative institutional studies also gained importance. Sweden could benefit from having the most diversified economic structure of the three countries, which may also be because its population is twice as large as that of Denmark or Finland. The product structure of exports and their geographic distribution also had a significant effect. Although Finland—as described above—in certain areas (the labour market and pension scheme) did not implement reforms as profound as those in Sweden, its growth prospects, which are worse than those in the other two countries, could not be attributed primarily to the lack of such reforms but rather to the fact that the sectoral restructuring of the industry is a time-consuming process.

These three countries are almost like a testing area in which the effects of the monetary union can be investigated. Sweden was able to use, and indeed used, the currency depreciation device, but Finland could not live with the possibility of independent monetary policy, and neither did Denmark, because it was a member of the ERM II. This difference, however, did not significantly influence the impact of the crisis. The effect of the depreciation of the Swedish krona was only temporary, and Finland and Denmark benefited from the monetary easing of the ECB, but its effect was also temporary. Finnish experts have also come to the conclusion that the application of the depreciation of currency does not have utmost importance in the crisis management, but this correlation is true only if the institutional system is functioning well (Korkman and Suvanto 2013).

Above, I have described the numerous hardships that Nordic countries have faced in the wake of the crisis. The EU's economic governance, the government documents created in connection with the EU 2020 strategy and other studies all indicate that, with their traditional professional governance, these countries are planning adequate steps to overcome difficulties and that these steps are adequately taken as well. For this reason, this model stands the chance of continual revival within the framework of the external restraints.

Notes

1. The total amount of the assets, as indicated in the analyses made by the Commission, was four times the GDP (ECFIN DG 2014o: 51; EC SWD 2014i: 13). By contrast, according to the statistical appendix of EC SWD (2014i: 42), in 2009, it was 320.1 per cent and continuously decreasing; in 2013, it was 289.1 per cent, and the same can be calculated on the basis of the ECB database.
2. The mentioned weak competition in the construction sector belongs to exceptionally poor examples.

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6

Different Development Paths in the North-Western Countries

6.1 The English-Speaking Countries: Diminishing Attraction

The fact that the economic crisis affected the UK and Ireland more severely than it did the other North-Western EU member states may raise doubts about whether in the future they will still be as successful as they were before the crisis when—as described above—they were among the most competitive within the EU, besides the Nordic countries. Therefore, it is reasonable to put these countries into an individual sub-category—as they were before the crisis—and investigate the institutional changes that have taken place since the outbreak of the crisis.

Economic growth in the *UK* was approximately 3 per cent before the crisis and only the decline beginning in 2008 pulled down the average to 2.4 per cent (Table 6.1). The easy access to credit and the rise in asset prices was stimulated by financial innovations and deregulated financial markets. Banks relied more on wholesale funding and securitisation than on the collection of deposits. When the disturbances occurred on the international financial markets and interbank lending became paralysed, asset prices dropped in the UK and interest rates soared. The financial

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Table 6.1 Some of the major macroeconomic indicators of the English-speaking countries 2004–2013

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment—volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T–1	Nominal unit labour cost index (2010 = 100)—percentage change T/T–1
Ireland								
2004–2008 average	3.7	4.9	4.1	30.0	189.7	–3.6	1.9	4.8
2009	–6.4	12.0	–27	62.2	258.5	–2.3	–1.6	–2.6
2010	–0.3	13.9	–17.6	87.4	261.1	1.1	–7.1	–7.4
2011	2.8	14.7	–2.2	111.1	277.9	1.2	–1.1	–3.2
2012	–0.3	14.7	5.2	121.7	281.5	4.4	–4.3	0.5
2013	0.2	13.1	–2.8	123.3	266.3	6.6	1.6	4.2
UK								
2004–2008 average	2.4	5.2	3.1	44.1	:	–2.0	–1.9	2.4
2009	–4.3	7.5	–16.7	65.9	:	–1.2	–9.6	4.8
2010	1.9	7.8	5.9	76.4	:	–3.0	0.9	1.8
2011	1.6	8.1	2.3	81.9	:	–1.3	0.5	–0.1
2012	0.7	7.9	0.7	85.8	:	–3.8	4.3	2.4
2013	1.7	7.6	3.4	87.2	:	–4.4	–1.5	1.4

Source: European Commission (2013a), Eurostat

crisis spread rapidly to the real economy, the consumption of the households and investments declined—in 2009, the economy shrank by 4.3 per cent. Real estate prices fell by 4.6 per cent in 2008 and by 9.2 per cent in 2009. The decreasing amount of tax revenues, the automatic stabilisers, and the restructuring of the financial sector resulted in the rapid increase of fiscal deficit; and public debt—which had previously been low—exceeded the Maastricht benchmark of 60 per cent as early as 2009. The Bank of England cut interest rates several times as of 2008 (in March 2009, the base rate was only 0.5 per cent) and increased the money supply, which meant substantial quantitative easing. As part of the latter, the Bank of England purchased primarily government securities in the amount of GBP 375 billion (accounting for one-quarter of the annual GDP) between 2009 and 2013. The cost of recapitalisation measures and asset relief interventions accounted for 6.5 per cent of 2012 GDP. The market share of the four largest banks was approximately 80 per cent, and in two of them, the government obtained ownership: 39 per cent in Lloyds Bank and 82 per cent in the Royal Bank of Scotland. By 2014, the government had reduced its share-holding in Lloyds to 25 per cent by way of reprivatisation (IMF 2013e: 16, 25; European Commission 2014g; EC SWD 2014j: 14).

Fiscal consolidation progressed, but with difficulties, although the deficit decreased from 10.8 per cent in 2009 to 5.8 per cent in 2013, including certain one-off revenues as well (for example, the transfer of GBP 28 billion from the Royal Mail pension fund). The public debt exceeded 87 per cent in 2013, and a decrease can be expected only from 2017–2018. Budgetary saving measures—which weighed heavily on community investments and welfare expenditures—held back economic growth anyhow, and the government tried to find the balance between the aspects of fiscal consolidation and stimulating growth. In order to find this balance, certain taxes were increased, but corporate tax was reduced to 20 per cent by 2015; thus, this became one of the lowest taxation rates in the OECD countries (EC SWD 2014j: 7–8).

The crisis made it quite obvious that in addition to the crisis management measures, the regulatory framework of the financial system had to be changed. Experts of the Bank of England have come to the conclusion that seeking self-interest does not create a self-regulating system,

as assumed by regulatory organisations before 2008. Their presumption concerning the attitude of the economic actors was not right; besides, the organisations regulating the financial sector were not adequate either in the UK. The spheres of authority were divided by three organisations and their cooperation was not efficient. The Bank of England, the Financial Services Authority, and Her Majesty's Treasury created a tripartite system, which was univocally condemned by the professionals after the crisis.[1] Since 2012, the supervision of the banks has been performed by Prudential Regulation Authority, which belongs to the Bank of England, and the supervision of certain non-bank financial institutions has been performed by the Financial Conduct Authority. The Financial Policy Committee, established under the purview of the Bank of England, oversees macroprudential policy. Although the efficiency of the institutional changes performed so far is questionable (for example, in the concentrated banking sector, the harmonisation of the micro- and the macroprudential supervision seems difficult), and the set of tools applied by the Financial Policy Committee is not strong either, the City is afraid that the increase in the regulatory burden may jeopardise the international competitiveness of the UK as a financial centre (IMF 2013e).

The financial sector remained dominant in the economy of the UK, regardless of the crisis. The trade surplus of the financial services was USD 64 billion in 2012, which is three times larger than that of the USA. As far as bank assets are concerned, the UK ranked fourth globally, following China, the USA and Japan; the UK ranked first in international bank lending, and the country defended its position in the forefront in the case of finance-related legal and accounting services (The City UK 2013: 4, 7). The experts of the European Commission are also convinced that there are signs—especially in London—that parallel to the recovery of the global economy, the export activity of the financial sector is gathering strength again. At the same time, a risk factor for the banking system for the future is that after adjustment, real estate prices began to increase again quite significantly, especially in London. Consolidated debt of the private sector in the case of both corporations and households stabilised after a temporary decline at a relatively high level, at approximately 180 per cent of GDP (ECFIN DG 2014q: 30, 44–45).

The UK lost 19.8 per cent of its global market shares during the five years of the crisis between 2008 and 2012, which exceeds the loss suffered by Germany or France. Losing global market shares did not stop in 2013, but its rate slowed down after 2011. The sharp depreciation of the sterling took place in 2008–2009, which did not facilitate exports because exporters increased their sterling-denominated prices, and in 2012, an appreciation followed. There has been a large deficit in the trade in goods since 1997 (6–7 per cent of GDP in recent years), which is counterbalanced by the dynamic increase in services. Not even the crisis could change this composition. There are persistent structural characteristics that explain the different dynamism of the export of goods and that of services. While the UK ranked seventh among the EU-27 member states between 2000 and 2010 in terms of productivity growth in services, the country ranked 16th in terms of the industrial sector. The differences concerning productivity growth are in line with the sectoral distribution of R&D performance. The UK is an innovation follower in the EU scoreboard, and R&D expenditure as a percentage of GDP was below the EU-27 average by 0.1–0.2 percentage points before and after the crisis as well. At the same time, the intensity of R&D investments in the UK in the field of services is one of the highest within the EU, and more specifically, the share of knowledge-intensive services within all services is one of the highest. By contrast, the intensity of R&D investments in the industrial sector is only tenth in the EU. Development of the industrial sector is hindered by the lack of a skilled labour force. While horizontally, the skill of the labour force is in line with the structure of the economy, vertically, there is wide discrepancy: more than 40 per cent of the labour force is either under- or overskilled; thus, there is a mismatch of labour market needs and skills. The extension of the apprenticeship programme has been seen as a possible way to tackle this problem (ECFIN DG 2013h: 30–31, 35). The 2012 PISA report showed that while the performance of the British students is average, public expenditure on the education system as a whole is around the OECD average, but public expenditure specifically on public education exceeds the OECD average (OECD 2013j: 5, 2014b: 257).

The flexible labour market is functioning surprisingly well; even experts are amazed. By 2013, the employment rate reached 74.8 per cent,

which is the highest value reached since 2008. This result is a result of the moderate rise in real wages and the expansion of part-time employment and self-employment. The expansion of part-time employment and the curtailment of welfare services theoretically would increase income inequalities, which were among the highest among the OECD countries (measured by the Gini coefficient of household disposable income). The impact of the crisis is controversial so far. The crisis has decreased the inequalities because the fall in real incomes was larger at the top of the income distribution than at the bottom; nevertheless, absolute poverty increased (André et al. 2013). The Gini coefficient decreased below the EU-28 average by 2013, but the rate of severely materially deprived persons increased from 4.5 per cent in 2008 to 8.3 per cent in 2013.

Regarding labour relations, decentralisation of wage negotiations had already taken place before the crisis. Trade union density was 26 per cent in 2011, including the 56.3 per cent level in the public sector, and the 14.4 per cent level in the private sector. As a consequence, collective bargaining coverage extended over 67.8 per cent of the public sector employees and 16.9 per cent of those employed in the private sector. Therefore, it does not come as a surprise that the crisis management measures were accompanied by few agreements between the social partners; major strikes were held in the public sector in 2011 due to the austerity measures (Eurofound 2014; Grimshaw and Rubery 2012).

The introduction of a profound reform in the welfare system is in progress. Within the Universal Credit programme—instead of individual welfare services—working-age people will be entitled to receive one single benefit; thus, welfare provision to those who are employed and to those who are not will not be separated. The reform is expected to make the system more efficient and to strengthen the incentive to work, and without a doubt, this transformation enhances the application of the means-tested principle compared to the universal service provision. The Labour government began to curb welfare services as a reaction to the crisis, and this was closely and strongly followed by the Conservative-Liberal Democrat coalition, which came to power in the 2010 election. The modernisation of the system had already begun before the crisis. By modernisation, the New Labour ideology meant that the actors of the civil or private sector would take an increasingly larger role in public

services, as opposed to the government. The coalition government is even more determined to follow this path, but in the context of the crisis, it is doubtful whether the fragmented system is able to provide the public services and to avoid even greater regional differences (Grimshaw and Rubery 2012). In connection with the investigation of the welfare system, one must face that the same facts can be interpreted quite differently depending on the approach of the researcher. Hemerijck (2013) recalls that Thatcher's reforms had taken the welfare state, which was showing more extended universal features, into the direction of a typical, Anglo-Saxon residual model. The author points out that as of 1997 the Labour Party—at the level of welfare provision, in case of certain institutions—became closer to the European welfare states, for example, the "New Labour" reforms were inspired by the active labour market traditions of the Nordic countries. In relation to the change of government in 2010, he finds that the turn of events matters and sees the logic of Thatcher's era reflected in the distribution of the burden imposed by the austerity measures. Grimshaw and Rubery (2012) emphasise the continuity of the neoliberal system, which became increasingly dominant as the crisis and the 2010 coalition government came about. Overall, statistical data to date have indicated that the relative position of the welfare system of the UK has not changed within the EU. The amount of social expenditure as a percentage of GDP is still close to the EU average. Nevertheless, regarding regional inequalities, unfavourable changes have happened. In 2007, only one region, West Wales, belonged to the category of the less developed regions (where per capita GDP is below 75 per cent of the EU average); in 2011, there were five. In 2007, 20 of 37 regions reached or exceeded the EU average, and in 2011, there were only seven such regions (European Commission 2010b: 12, 2014d: 2). The increase in the regional inequalities is associated with the fact that in the regions that had been affected by the industrial decline, the public sector provided two-thirds of the growth in working places during the boom years, which then fell victim to the austerity measures.[2]

In the economy of *Ireland*, the imbalances started to accumulate well before the global financial crisis. As we have seen in Part II, since the beginning of the 2000s, economic growth was diverted from the export-driven path and was heated by internal demand, especially by the growth

in the construction industry. Housing investments began to decrease as early as in 2007 by 15 per cent and in 2008 by an additional 30 per cent. Economic decline had been 2.6 per cent in 2008 before the slowdown of global economic growth, which was followed by a 6.4 per cent contraction in 2009. With the burst of the real estate bubble, the banking sector began to suffer huge losses, and it collapsed before the Lehman Brothers' bankruptcy in the USA. The government immediately—almost in a panic—introduced a guarantee not only for deposits but also for other liabilities of the six largest banks. Owing to the intertwining of the Irish banks with the European banking system, there was such a huge pressure on the Irish government that it could never withdraw this guarantee. This weighed extremely heavily on the budget: between 2008 and 2012, 40 per cent of the 2012 GDP was spent on recapitalisation of the banks and asset relief interventions. In the 2000s, Ireland recorded fiscal surpluses, but in 2009, the deficit was 13.9 per cent, and in 2010, it was 32.4 per cent, in which the costs of the bank bailout took a great part, naturally, in addition to the decrease in revenue resulting from the economic decline. In this context, the Irish government required the support of the EU and the IMF. The financial assistance package included contributions from the EU of EUR 45 billion and from the IMF of approximately EUR 22.5 billion, and the use of Irish financial assets amounted to EUR 17.5 billion (EC SWD 2012b: 4; European Commission 2014g; OECD 2009c: 18, 31).

The path leading to the crisis has been reconstructed by Irish and international (EU, OECD) experts similarly. In the favourable international environment, loans became available with low euro interest rates in the Irish banking system. This lending was covered not so much by deposits, but rather by short-term financial resources obtained from the interbank markets. Ireland—similar to Spain, Portugal, and Greece—offered great investment potential, especially in the real estate sector. Tax allowances offered for real estate development were not withdrawn by the government due to the coming election, although the signs of overheating had clearly been visible by that time. At the peak of the boom, the contribution of the construction industry to GDP reached 20 per cent. In the increasing competition, bank lending began to extend over riskier transactions, and the loose regulatory measures and the inefficient

bank supervision were not able to stop it. During the restructuring of the banks, the National Asset Management Agency collected the toxic assets, more than 60 per cent of which originated from the Anglo-Irish Bank; however, this bank accounted for only 18 per cent of the market. Failures of their management and their unacceptable practices in the case of the banks, especially in case of the Anglo-Irish Bank (which was nationalised as part of crisis management), all contributed to the evolvement of the financial crisis, and these deficiencies were not eliminated by the market competition (contrary to the neoliberal presumption) and did not manifest in a decrease in bank shares. The institutional changes necessary for strengthening the banking supervision were accomplished in 2010–2011. Financial regulation and supervision were placed back under the purview of the Central Bank of Ireland, from which they had been detached in 2003. From loose principle-based regulation, they changed over to a more tightened rule-based regulation (Clarke and Hardiman 2012; OECD 2009c). The share of non-performing loans (NPL) was still 24.6 per cent in 2013, which presents further risk for the banks and makes them unprofitable. The size of the banking system decreased significantly, total assets of the banking sector were ten times the GDP in 2009, but in 2013, it was only six times the GDP (EC SWD 2014s: 43).

The Irish government—partly due to the pressure from the Troika (EU, ECB, IMF)—performed an inexorably consistent fiscal consolidation. The government managed to decrease the deficit from 30 per cent in 2010 to 8 per cent in 2012, and according to the government's plans, the deficit would drop below the 3 per cent Maastricht benchmark by 2015. Fiscal measures implemented between 2011 and 2013 total over EUR 13 billion (8 per cent of GDP), two-thirds on the expenditure side, including a EUR five billion decrease in current expenditure and a EUR 2.7 billion decrease in investments. As the result of the consolidation efforts, Ireland was able to pay back the loans and to close the related agreement (which was concluded in 2010) in 2013. The institutional framework of persistent fiscal discipline was strengthened, fiscal planning containing the medium-term and annual expenditure ceilings was introduced, and in 2011, the independent Irish Fiscal Advisory Council was established, with a wide sphere of authority (IMF 2013b: 5–6). In light of the above measures, public debt is expected to sink below 110 per cent in 2015.

Economic growth was hindered by the curtailment of public spending and the indebtedness of the households and the corporations, which was related (in both sectors) to real estate investments. In 2012, the consolidated debt of the private sector was 281.5 per cent of GDP. In the case of enterprise indebtedness, it must be mentioned, however, that a substantial part of the debt is related to Ireland's large multinational corporation sector, representing just 2 per cent of the companies and accounting for 57.4 per cent of the gross value added of all domestic enterprises. Deleveraging began in the case of indigenous firms as well as in the case of households. The latter have reduced their debts by almost 20 percentage points relative to GDP, but the rate has remained above 100 per cent, which is one of the highest in the EU (ECFIN DG 2014i: 19–22).

In view of the subdued domestic demand, only exports can enhance economic growth in which the Irish economy has achieved good results, as far as the fluctuating external economic environment made it possible. After the outbreak of the crisis, profound adjustment was accomplished in the Irish economy. Real property prices decreased by 51 per cent between 2007 and reached their lowest point in March 2013. Since then, the housing market has stabilised, and housing prices have begun to rise in Dublin (ECFIN DG 2014i: 23). The decline in ULC between 2008 and 2010 was the greatest within the euro area, partly because labour productivity increased and partly because wages were kept low and the REER was devalued. Current account deficit hit the deepest point in 2008 at 9.4 per cent, and in 2010, it swung to a surplus. The structural changes in the economy have resulted in productivity growth, and the sectors with lower productivity—construction and tourism—have shrunk. The multinational companies operating in the high-technology sector have become engines of growth, primarily in the pharmaceutical and chemical industries. Consequently, there has been a shift towards tradable sectors. Within industry, the greatest losses were suffered by the domestically dominant food industry. The structural duality of the Irish economy—as described in Part II—became more profound as a result of the crisis. This also causes great difficulties because employment creation is focused in the domestic SME sector. Within services, computer services show huge development but—in spite of the fact that in this field, the role of the domestic firms is important and sig-

nificant—in the field of exports, multinational companies take the lead. The Irish economy as a whole belongs to the category of the innovation followers within the EU, but 70 per cent of the R&D expenditure of the business sector comes from foreign-owned companies (ECFIN DG 2014i: 38–46; Pina 2011: 32).

Owing to the economic decline and the fiscal austerity measures, the unemployment rate jumped to 13–14 per cent, which was too much for the flexible labour market to tackle. What made the situation even worse was that the decline was the greatest in the labour-intensive sectors, for example, in the construction industry and in tourism, where a great proportion of the unskilled labour force was employed. A dangerous feature of unemployment is that the proportion of the long-term unemployed exceeds 60 per cent, which may lead to a rise in structural unemployment. Youth unemployment, with its 26.8 per cent level, still exceeded the EU average in 2013. The economic difficulties changed the direction of migration (which had been dominant for two decades) in 2011: net emigration included 34 thousand people, and half of them were Irish citizens (OECD 2013h: 260).

Further liberalisation of economic policy was the answer to the problems of unemployment, which affected primarily the public sector. The unemployment benefit system changed as well, but in practice, it involved only those below 26 years of age; thus, it remains to be seen how successful it will be in decreasing long-term unemployment. Due to the structural changes in the economy, the discrepancy between labour market demand and supply has increased (compared to the pre-crisis state of affairs); for instance, employment in the construction industry will not return to its earlier level. Consequently, the application of the measures of the government's active labour market policy has become necessary. In Ireland, even before the crisis, there was a dual system in vocational training and education, with the active participation of social partners. However, the majority of the apprenticeship positions were available in the construction industry—meeting the earlier labour market needs; therefore, the transformation of this system is in progress as well (EC SWD 2014s; OECD 2013f; Pina 2011). Ireland has always considered education a field of strategic importance even during the crisis: according to OECD data, public spending on education climbed over 6 per cent

of GDP in 2010–2011, and it has been reflected in the Irish students' above-average performance in the 2012 PISA report (OECD 2013j: 5, 2014b: 257).[3]

Expenditures on social protection benefits (at a level of 18 per cent of GDP) were low compared to the EU before the crisis, and the proportion of means-tested benefits as a percentage of GDP exceeded by far the same figure for the UK. In Ireland, these expenditures amounted to 4.4 in 2007 and, in the UK, to 3.5 per cent (EC SWD 2014j: 39, 2014s: 45). However, in view of the temporal trend, in the years of rapid economic growth, the sphere of state-provided welfare benefits dynamically widened. This process was broken by the crisis, and the austerity measures affected all areas of welfare benefits from the family supporting benefits through the increase in retirement age to the introduction of a less generous pension scheme (Hemerijck 2013). During the crisis, the indicators of poverty as well as social inequalities rose equally, but data also suggest that welfare transfers substantially decrease the risk of poverty (Table A.8).

Social partnership does not have deep roots in Irish society. The Irish economy skipped the post-war "Golden Age" of the welfare state. Ireland's relations to the UK, its agricultural economy and the social importance of the Catholic Church, which was against the redistribution of income, all drove the country towards a minimalist, residual welfare state, which was very similar to the practice pursued by the Southern-European countries (Dukelow 2011). As of 1987, three-year agreements were concluded by the state, the employers and the trade unions; thus, social partnership evolved. However, this served the purpose of maintaining the competitiveness of the country rather than the development of a welfare state. This result can be seen as an explanation to the fact that trade unions were rather passive when the crisis hit the country. These trade unions concluded the Croke Park agreement for the period between 2010 and 2014. Pursuant to this agreement, wages have decreased by 25 per cent in the public sector since 2009 (Erne 2013: 42). This must be considered a huge step backwards, even if we take account of the fact that in the boom years of the Celtic Tiger, the non-tradable sector, specifically the public sector, was the main beneficiary of the increase in wages. However, in 2013, it turned out that the decline in income is not enough for the undertaken

decrease in deficit. Croke Park II on another decrease of average 7 per cent was not signed first; however, the revised agreement under the name of the Haddington Road Agreement was signed by several trade unions, and as a result, it entered into force on 1st July 2013 (Table 6.2).

As seen in Part II, the economic and social systems of both the UK and Ireland correspond—only as far as certain sub-systems are concerned—to the ideal type, which is identified in literature as the Anglo-Saxon model that evolved during the 1980s. However, the USA and the UK share certain features of their development path, and these features gained crucial importance during the 2008 crisis. Ireland also shares these features, namely, that the liberalised financial system, the mortgage-based securitisation and real estate development were the engines of economic growth. This also means that in case of the two European countries, the crisis did not come merely as a contagion that spread through global economic relations as an exogenous impact, but there was an endogenous factor as well. The question arises of how it will affect the institutional system if—due to the crisis—the sources of growth (as described above) cannot function in the same way they did earlier.

Regarding the processes of the crisis and those of crisis management, the UK and Ireland presumably will take different paths. The UK's role as an international financial centre is based on centuries-old experience and expertise, and income originating from this sector cannot be replaced either from the aspect of national economy or that of government budget. It has been a recurrent suggestion from British experts as well as from experts of international organisations in the context of economic development that the role of industrial production and that of the related services must be increased; however—as Hay (2013) points out—neither public opinion nor academic circles mentioned the necessity of a comprehensive change of strategy. Huge investments would be needed for an export-driven growth strategy, but the necessary capital is missing. New markets would be needed, where other competitors would be more experienced; furthermore, no rapid growth can be expected within the EU. Realistically, only incremental changes might be expected. In vocational training, the government is clearly for a shift towards the dual system and tries to involve the employers as well by financial incentives to employ young people in the framework of the apprenticeship sys-

Table 6.2 Changes in the institutional systems of the English-speaking countries after 2008

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Before 2008						
Liberalised	Innovation system above the EU average, but an innovation follower type of innovation system	Highly developed banking system in the UK with developed financial market	Fully liberalised, role of the active labour market policy is meagre	Role of trade unions is modest, social partnership is stronger in Ireland	Extended use of means-tested principle, but the UK's social expenditure is close to the EU average	No strongly marked model
Characteristic institutional and regulatory features after 2008						
UK						
No change	Innovation follower, R&D more intensive in services	Tightening loose regulation, financial centre role remains; after real estate price correction, prices rise again	No change	No change	Austerity measures in social welfare provision including pensions, means-tested principle is strengthening	Average PISA results, shift towards dual vocational education and training

Ireland						
Duality between international and domestic economies has deepened	Innovation follower, R&D is focused in foreign-owned companies	Tightening loose regulation, the size of the banking system decreases, real estate bubble	Strengthening labour market activation, further increase in flexibility	Trade unions have a cooperative but subordinate role	Austerity measures in social welfare provision, including pensions	Above-average PISA results, the structural conversion of the economy generated retraining tasks

Source: Author's compilation

tem. Thus—similar to Ireland—a hybrid solution would result, because in the VoC literature, it is compatible with the flexible labour market when employers do not spend money on the education of those who can change jobs easily.

Introducing more tightened regulation in the financial system and transforming financial supervision demonstrate a clear detachment from the institutional solutions in use so far, which were based on liberal regulation. The sustainability of the new regulation depends largely on the international environment. When defending its interests, the City strongly puts forward the argument that the increasing burdens of regulation jeopardise the UK's position among the most important financial centres of global economy (The City UK 2012). In the USA, the long-term impacts of the Dodd-Frank Act on the new financial regulation cannot be seen yet, but financial institutions have already started to look for loopholes, and financial lobbyists have already started to fend off the regulations in those fields that are not within the scope of the Act (Deeg 2012).

After half a decade of the crisis, there are no signs of a radical institutional transition in the British economy. At the same time, it is not likely that the financial system plays the same dynamising role as it did before the crisis. The functioning of the European banking supervision and the Basel III provisions concerning capital standards all make it quite likely that—in spite of the lobbying activity of the financial sector—things will not be back on track. Indebtedness of households also makes it impossible for loan-based consumption and real estate development to again be the engine for growth in demand. This possibility is also hindered by the fact that a generation who obtained loans to pay their high education fees is entering the labour market.

The future of institutional development in Ireland is an open question. Although the Irish financial system exceeded the British system in relative terms and the export of financial services is strong, the financial system does not have the same central role as it has in the British economy. Its oversized development is closely related to real estate development and the related lending activity. Because the indebtedness of the Irish residents is dangerously large, getting back to the earlier development path is even less likely than in case of the British. Furthermore, Ireland's

euro area membership provides less room for manoeuvring in the field of regulation than in case of the UK.

The most critical issue in Ireland is whether the productivity of the domestic economy is able to catch up with rapidly recovering multinational companies. If the dual economy persists, Ireland will take the same development path as the Baltic states—but at a higher income level—that is, Ireland will be able to keep up its competitiveness only if wages and welfare provisions remain at a low level relative to its European neighbours. In addition, social partnership presents assistance to this economic policy. If they succeed in keeping the difference between the productivity of the multinational large corporations and the domestic SME sector down, at a level similar to that of other developed countries, the development of Ireland may be similar to that of another small North-Western EU member state, such as the Netherlands.

6.2 Enduring German Economic Hegemony and Postponed French Reforms

During the years of the crisis, the positions of the continental countries rearranged. Germany—which had been referred to as the "sick man" of Europe for more than a decade after the unification of Germany—is now often described as the hegemonic economy of Europe, in contrast to France, the recovery of which seems to be slow. The Benelux countries were variously burdened with stabilising their financial sectors. Austria has gone through the difficult years quite well (Tables 6.3 and 6.4). Let us examine the two large continental economies.

Germany was hit by the economic crisis after the 2006 jump in growth. It happened already in 2007 that certain banks which had invested in the mortgage market of the USA (Hypo Real Estate, Sachsen Landesbank) got into trouble but the German politicians were hoping at that time that the crisis fundamentally remained an American problem. The German banks had substantial outstanding claims in the Mediterranean countries as well; for example, consolidated claims towards the Spanish banks amounted to almost one-quarter of Spanish GDP. In 2008, an act stabilised the financial markets, and the German government launched

Table 6.3 Some of the major macroeconomic indicators of Germany and France 2004–2013

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment—volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T–1	Nominal unit labour cost index (2010 = 100)—percentage change T/T–1
France								
2004–2008 average	1.8	8.8	3.7	65.7	112.9	–0.9	0.3	1.9
2009	–2.9	9.1	–10.6	78.8	130.5	–1.3	0.4	3.5
2010	2.0	9.3	2.1	81.5	131.8	–1.3	–4.1	0.9
2011	2.1	9.2	2.0	85	135.3	–1.8	–0.7	0.9
2012	0.3	9.8	0.3	89.2	138.2	–2.2	–3.2	1.8
2013	0.3	10.3	–1.0	92.2	137.3	–1.3	1.6	1.1
Germany								
2004–2008 average	2.0	9.7	2.9	67	114.1	6.0	–0.1	–0.4
2009	–5.6	7.6	–11.7	72.4	113.4	5.9	1.0	6.3
2010	4.1	7.0	4.9	80.3	107.7	6.4	–5.2	–1.2
2011	3.6	5.8	7.3	77.6	103.9	6.8	–0.7	0.6
2012	0.4	5.4	–0.7	79	103.7	7.4	–3.3	3.3
2013	0.1	5.2	–0.6	76.9	103.5	7.5	2.2	2.4

Source: European Commission (2013a), Eurostat

Table 6.4 Some of the major macroeconomic indicators of the smaller continental countries, 2004–2013

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment—volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T–1	Nominal unit labour cost index (2010 = 100)—percentage change T/T–1
Austria								
2004–2008 average	2.8	4.6	1.2	63.1	126.4	3.3	–0.2	1.1
2009	–3.8	4.8	–7.8	79.7	132.9	2.7	1.1	5.2
2010	1.9	4.4	–2.4	82.4	133.4	3.4	–3.4	0.1
2011	3.1	4.2	6.8	82.1	130.3	1.6	0.4	0.7
2012	0.9	4.3	0.5	81.7	128.3	2.4	–1.8	3.0
2013	0.2	4.9	–1.5	81.2	125.5	2.7	2.1	2.6
Belgium								
2004–2008 average	2.3	7.9	5.0	89.4	130.9	3.2	0.8	1.9
2009	–2.6	7.9	–8.4	99.3	161.5	–0.6	0.5	3.7
2010	2.5	8.3	–0.1	99.6	155.6	1.9	–2.6	–0.5
2011	1.6	7.2	4.0	102.1	165.0	–1.1	0.6	2.8
2012	0.1	7.6	0.0	104.0	161.1	–1.9	–2.3	3.6
2013	0.3	8.4	–2.2	104.5	163.0	–1.6	1.5	2.0
Luxembourg								
2004–2008 average	4.1	4.7	5.8	8.0	:	9.8	1.2	3.1

(*continued*)

Table 6.4 (continued)

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment—volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T–1	Nominal unit labour cost index (2010 = 100)—percentage change T/T–1
2009	–5.3	5.1	–16.2	15.5	421.8	7.3	0.9	8.3
2010	5.1	4.6	–0.2	19.6	346.1	7.7	–1.6	–1.1
2011	2.6	4.8	14.4	18.5	347.3	6.6	0.7	2.4
2012	–0.2	5.1	2.4	21.4	340.6	5.8	–1.5	4.2
2013	2.0	5.9	–4.5	23.6	356.2	5.2	1.5	3.6
The Netherlands								
2004–2008 average	2.7	4.3	3.9	51.1	216.7	7.6	–0.3	1.0
2009	–3.3	3.7	–12.0	56.5	231.4	5.2	1.9	5.0
2010	1.1	4.5	–5.6	59.0	229.4	7.4	–3.9	–1.3
2011	1.7	4.4	5.6	61.3	228.0	9.1	–0.4	1.0
2012	–1.6	5.3	–6.0	66.5	230.2	9.5	–1.8	3.6
2013	–0.7	6.7	–4.0	68.6	229.7	10.4	2.7	1.6

Source: European Commission (2013a), Eurostat

stimulus packages aiming at assisting growth and employment, altogether amounting to 3.1 per cent of the 2008 GDP between 2008 and 2010 (OECD 2010c: 63). In 2009, this measure could not prevent the 5.6 per cent decline of GDP due to the world trade collapse. Expenditures on financial and economic consolidation elevated public debt over 80 per cent in 2010. In 2012, the budget showed a surplus, and it seems that Germany is able to return to a budget that is sustainable in the long run, in which the greatest risk is the ageing of society (EC SWD 2014q).

In Germany, the financial crisis was not fuelled by a real estate crisis. The supply of the real estate market was increased by the subsidised construction of houses after the unification, while the low level of population growth, higher real interest rates (compared to other countries), and tighter regulations concerning mortgages held the demand back. Nevertheless, the recapitalisation of the banking system and the asset relief interventions between 2008 and 2012 amounted to 5.5 per cent of the 2012 GDP (European Commission 2014g). The regionally organised state-owned *Landesbanken* were the sources of one-third of the losses, one part of which undertook risky transactions, as they were politically influenced. Although in 2011, an act was passed on the restructuring of the banks; the reform of the *Landesbanken* proceeded slowly. The state (*Land*) guarantee behind these banks will be terminated until the end of 2015 due to the regulation of competition in the EU. The banking system is based on three individual pillars: privately owned (commercial) banks, banks owned by the public sector (saving banks and *Landesbanken*), and credit co-operative banks; this system makes the banking system quite fragmented. The capital adequacy ratio of the banks was low before the crisis, and in spite of the restructuring, banks remained vulnerable, although their capital started to increase. Between 2008 and 2012, the core tier 1 capital of the 12 largest German banks to the risk-weighted assets increased from 8.3 per cent to 13.6 per cent. The system of financial supervision did not perform well in Germany either during the crisis, the new act that meets the EU requirements concerning the regulatory framework entered into force as of 1 January 2013. As a result, the Financial Stability Commission was set up that consists of the representatives of the *Bundesbank*, the Federal Financial Supervisory Authority and the Federal Ministry of Finance. More efficient micro and

macro prudential supervision is expected from the regulatory body. The operation of the Financial Market Stabilisation Fund was extended until 2014 (EC SWD 2013g: 15–16).

Regardless of the difficulties of the financial system, Germany has proved to be quite successful in the real economy, the source of which can be found in the country's international competitiveness. After the lowest point in international trade in 2009, German exports began to grow rapidly again, and by 2010, both exports and GDP exceeded the pre-crisis level. In addition to the usual surplus of the merchandise trade balance, the usual deficit of the services balance decreased. Thus, the current account surplus exceeded 6 per cent of GDP as of 2010, which is the reference value in the EU's excessive imbalance procedure (the range between +6 and −4 per cent is considered the balance). The competitiveness of Germany has strengthened for several reasons. As of the mid-1990s, the companies relocated the labour-intensive phases of their production to countries where wages were lower. Deeper integration into the global value chain is shown in the decrease of German value added of export products. Wages were strongly kept down after the mid-2000s, correcting the expenditure on wages that had soared after the unification. The extent of wage moderation was greater in the tradable sectors. Between the introduction of the euro and the onset of the crisis, REER deflated by GDP within the euro area fell by more than 10 per cent, which was accompanied in other—mainly Mediterranean—member states of the EU within the euro area by an increase in REER and an increase in current account deficit. During the crisis, REER depreciated towards the non-euro-area partners (due to the nominal depreciation of the euro), and ULC increased over the euro area average due to the increase in wages. Non-price competition is demonstrated by the fact that between 1995 and 2007, German companies increased their market share in almost all segments of the R&D-intensive industries. Germany is one of the EU's innovation leaders in the innovation scoreboard of the EU and during the years of the crisis already the non-price factors dominated in competitiveness (Belitz et al. 2011; ECFIN DG 2014g; European Commission 2014c: 5).

The German export companies specialised in exporting investment goods in the 2000s because, this way, they could improve their market

position in the emerging countries. Germany could increase its market share in the R&D-intensive sectors, specifically in machinery and the automotive industry. Although the crisis hit these sectors as well, it proved to be only temporary. At the same time, the geographical distribution of German exports has changed. While in the pre-crisis decade, the share of the euro area in German exports was approximately 46 per cent, in 2012, it dropped below 40 per cent. In 2007, almost 60 per cent of the German current account surplus originated in the euro area, but in 2012, barely one-third did. The main reason for the decline was the contraction of demand caused by the crisis of the Mediterranean countries. At the same time, the decline in exports was not accompanied by a proportionate decrease in imports. Furthermore, imports originating from the four Mediterranean countries between 2009 and 2012 increased by 25.8 per cent, while German exports towards the same countries increased only by 2.4 per cent. As a consequence, a certain adjustment of the pre-crisis imbalances has been accomplished within the euro area. As of 2008, the current account surplus surged—compared to countries outside Europe—due to the commercial activities performed partly with the USA, partly with the emerging countries. Germany managed to decrease deficit *vis-á-vis* China (ECFIN DG 2014g: 84–85, 88; Jannsen and Kooths 2012: 369). The success of German exports is further enhanced by the fact that the most important companies are present in many countries with many products. German companies manage their exports via long-run customer and market relations, similar to their domestic economic activities. They can utilise this traditional institutional feature of the German economy because they export investment tools and not standardised goods. German experts call our attention to the export activity of German companies, which is successful outside of Europe as well, may help the economy of the euro area countries, which have been hit heavily by the crisis. The latter companies can integrate themselves into the global value chains of German exporters and enter the international markets together, which would otherwise be impossible due to high entry costs (Jannsen and Kooths 2012).

However, all these successes were not enough to protect Germany from losing global market share (10.7 per cent) between 2008 and 2013, which is—to a certain extent—inevitable for the developed countries as

a result of the appearance of the emerging countries. In the pre-crisis decade, labour productivity growth in the entire German economy was under the OECD average and fell behind the growth level of the USA or the UK (Erber and Fritsche 2009). After the decline caused by the crisis, the growth rate seemed to return to the pre-crisis level (between 1 and 2 per cent) in the coming years.

In connection with the German economy, the dilemma often arises in which the savings of the households as well the companies are so high, while, at the same time, the domestic investments of the companies and consumption are so low that it may pull back economic growth and Germany may become too exposed to external demand. The analysis made by the European Commission provides a detailed account of all those varied impacts, the result of which is a great amount of savings. In case of households' increasing income inequalities (after the 2000s), the taxation policy and awareness of the social problem of ageing played a role in the increase in savings, which limited the growth of consumption. Wage moderation also contributed to the slow increase in consumption. German companies were attracted to foreign investments because, with the introduction of the euro, external risks diminished, and higher profits and increased demand were available abroad. In Germany, tax rates were higher; credit conditions were less favourable, which again encouraged foreign activities. The increase in savings in the case of companies may have been influenced by international expansion and the wish to be independent from bank financing. A further reason for low domestic investment in the German economy is that a source of public savings was the decade-long curbing of infrastructural investment, and currently, it has reached a point where it hinders the development of the entire economy (ECFIN DG 2014g).

The performance of the German economy during the crisis is often considered a success story because Germany increased employment. Unemployment increased by only 0.2 percentage points in 2009, at the deepest point of the crisis. In 2013, the employment rate was 77.3 per cent, and the unemployment rate was only 5.2 per cent. Several factors made this possible. The working age population decreased a little bit—compared to the other OECD countries—in the years of the crisis. The decline affected the tradable sector, where capital-intensive production is

taking place. At the same time, the labour-intensive, non-tradable sectors (for example, the construction industry) did not decline, and because there was no real estate bubble, private consumption did not decrease either. Because before the crisis, there was a labour shortage in many companies, during the crisis, the companies opted for keeping their employees. However, the institutional reforms of the labour market were even more important. These are known as the already-mentioned Hartz reforms in the 2000s. These reforms provided a framework that made adaption easier during the crisis. The extension of the short-time work scheme was encouraged by reducing the employee-paid social security contribution. As a result, according to the estimations, 235,000 workplaces have been saved, which accounts for 0.6 per cent of employment. Collective agreements have become more flexible, and company-level agreements have been signed in order to maintain employment, with the applied tools of reducing weekly working hours and suspending annual bonus payments. After the elections in 2013, a grand coalition was formed, and one of the conditions imposed by the Social Democrats was the introduction of the general minimum wage as of 2015. It is too early to assess the impact of the general minimum wage on employment (EC SWD 2014q; Hüfner and Klein 2012: 13).

Despite these successes, there are still challenges the German employment policy has to face. Owing to the rapidly ageing population, it would be very important that women's participation in the labour market should increase; in Germany their participation—specifically with regard to the number of hours worked—is below the average of the developed countries. Tax regulations and the shortage of childcare facilities hinder full-time female participation, it is clear that the institutional system moves towards the dual-earner-based family model with difficulties. Women account for two-thirds of all employees working in "Mini-Jobs". During the crisis, the share of workers with fixed-term contracts rose substantially: they accounted for 15 per cent of all employees, but among those aged 15–24 years, 57 per cent had a fixed-term work contract. The difference between EPL for regular work contracts and fixed-term work contracts is also greater than in many other developed countries. This situation carries the risk that firms are less likely to invest in the training of the young; therefore, social disparities will increase. The dual vocational system has

already been weakened by the fact that many young people with migrant backgrounds cannot obtain in school the knowledge required for apprenticeship training. The number of people participating in higher education is not enough to meet the anticipated needs of the labour market; thus, as of 2007, the Higher Education Pact 2020 has aimed to provide help by increasing state support to higher education. Regardless of the crisis, in 2011, the second phase of the programme (until 2015) began amounting to EUR 4.7 billion (Hüfner and Klein 2012: 25–26). German students performed above average according to the 2012 PISA report. This was achieved when public spending on education was only 5 per cent of GDP (below the OECD average) (OECD 2013j: 5, 2014b: 258).

Owing to its high performance, Germany did not have to apply such austerity measures in the social welfare provisions as many other countries did. In 2010, as part of the savings package, certain transfers were curtailed (Hemerijck 2013: 358–359). In 2013, the grand coalition was formed, increasing the pension benefits of certain groups and making early retirement possible. The indicators of income inequalities showed improvement during the crisis, and the poverty indicators are below the EU average; nevertheless, these indicators are among the highest among the North-Western countries (EC SWD 2014q; Table A.8).

Because the reforms in Germany began to achieve some results just before the crisis, it is not surprising that their responses to the crisis did not bring any great changes in the institutional system: the same contradictory processes that had started in the 1990s continued. These changes were incremental in nature, they were built onto the old institutions, and therefore, a kind of layering occurred. As demonstrated in Part II, due to the impacts of the EU and the globalisation effects, the financial system has shifted from the banking system (acting as "patient capital") to a more liberalised, more market-oriented financial system. In corporate management, the "stakeholder" attitude has been replaced by the "shareholder" attitude. This replacement has been complemented by the steps taken to liberalise the labour market, weaken trade union density, and decentralise collective bargaining. At the same time, the crisis specifically enhanced the traditions of corporatist cooperation and helped the country pull through the crisis and avoid mass unemployment (Lehndorff 2012). In certain areas, old institutions developed further. As far as

labour relations are concerned, cooperation remained strong, and works councils have been reorganised in order to operate more flexibly. In dual training—which has served as an example in many countries in the field of vocational training reforms—more comprehensive professional skills have received more emphasis, and employers have remained the main partners of the state in running the training, while trade unions have been pushed to the background (Jackson and Sorge 2012).

It is worth noting that in international economic relations, the same has proven to be the key to German success as underlined by all institutional analysis without exception, which is an essentially German feature: the cooperation and coordination between economic actors. The sustainability of the present group of institutions is jeopardised mainly by the demographic processes and by the duality of the labour market and its social and economic consequences.

France had a less open economy than Germany; therefore, the 2008 crisis caused a lower decline, which was at –2.9 per cent in 2009. The automatic fiscal stabilisers functioned efficiently. In the two years after 2009, it seemed that the economy could return to the pre-crisis—that is, not too strong—dynamism, but after 2012, the economy was again close to stagnation. The unemployment rate climbed to almost 10 per cent, and it has been prognosticated that it currently remains there. Similar to the other governments, the French government also took measures to tackle the crisis in order to stabilise the banking system and to boost the economy. The banking system was in a relatively better state than in many other countries, thanks partly to its diversified activity and partly to a relatively prudent approach to lending. Nevertheless, government intervention was necessary as well. An entirely state-owned agency (*Société de Prise de l'État*) has been set up for the recapitalisation of banks, and in order to ensure their liquidity, and the seven leading French banks established an organisation (*Société de Financement de l'Économie Française*), one-third of which was owned by the state. The cost of recapitalisation between 2008 and 2012 amounted to 1.3 per cent of the 2012 GDP. The instruments for stimulating the economy (infrastructural investments, supports provided to SMEs, and so on) were not of outstanding volume, either, accounting for 1.25 per cent of GDP. However, besides decreasing revenue, the fiscal deficit was still 7.2 per cent in 2009. The decline in

revenue actually began in 2007 due to the tax reductions. The deficit will not reach the Maastricht reference value of 3 per cent for years. Public debt exceeded 90 per cent in 2013, and it will certainly rise for a few years, although in 2007, the French public finance met the Maastricht criteria. Regarding long-term sustainability, France is in a more favourable position than most of the EU member states because due to the favourable demographic situation, the anticipated costs of ageing are lower. The fiscal discipline is expected to be helped by the High Council for Public Finances, an organisation that is independent from the government and that was set up in 2012 (EC SWD 2014p: 13–14; European Commission 2014g; OECD 2011a: 24).

The banking system stabilised after the difficulties of the crisis, and the top five banks—holding 80 per cent of all banking assets—increased their capital, thereby meeting the Basel III provisions concerning capital standards by 2013. At the same time, there are some vulnerable points in the banking system. The claims of the French banks towards four European Mediterranean countries (Greece, Italy, Portugal, and Spain) and Ireland are still considerable, although their volume has decreased gradually since 2009, when these claims amounted to 15.7 per cent of GDP. Another critical issue is that the French banks are too reliant on wholesale funding. With the help of an act passed in 2010, the system of financial supervision was renewed, which has functioned rather well since (OECD 2011a: 28–31). From the viewpoint of the stability of the financial system, it was beneficial that there was no housing bubble. Although the real prices of real property increased by an annual 9 per cent between 2000 and 2007, in the course of two years during the crisis, correction was only 7 per cent, and in 2011, real estate prices already exceeded the 2007 level and then fell slightly again. As a consequence, the indebtedness of households—the majority of which derives from mortgages—is not critical, although the increase in debt has not ceased. Nevertheless, having the low level of new lending in mind, it can be predicted that the stock of debts will decrease gradually. In the corporate sector, the level of indebtedness is slightly higher than the EU average, and although its decrease has not started yet, measured using the debt-to-equity ratio, it is not particularly worrying (ECFIN DG 2014f: 45).

The greatest challenge the French economy must face is the improvement of competitiveness. The current account deficit is approximately 1.5 per cent, which is below the –4 per cent EU reference level, but in the decade before 2005, it was positive. France lost 21.5 per cent of its shares in the export market of goods and services between 2003 and 2008 and 13 per cent between 2008 and 2013, due mainly to the losses suffered in the market for goods. With the increasing exports of emerging countries, the volume of the global market increases therefore—similar to the other developed countries—the French economy cannot avoid the deterioration of its relative position either, but its extent is one of the greatest in the EU. One of the reasons why France was less successful in redirecting its exports to the rapidly growing economies was that 48.2 per cent of its exports were directed to the euro area in 2011. Furthermore, while 69.3 per cent of the German industrial products were high-tech, or medium-high-tech products, these products in France represented only 62.0 per cent because high-tech sectors (for example, the pharmaceutical and aeronautical industries) proved to be resistant during the crisis, on the other hand, the medium-tech sectors were hit heavily. The price factors and the cost and non-price factors of the French economy's competitiveness deteriorated in the 2000s. Labour productivity increased at the same rate as the average of the euro area, but wages increased more rapidly; therefore, ULC increased more rapidly, even if not as quickly as in Italy or in Spain. Nevertheless, this growth was in sharp contrast with the German evolution of events. Not only did the expenditure on wages contribute to the increase in costs, but also that in the field of services competition was modest. French companies also reduced costs by relocating their production to CEE or to the Maghreb countries. However, as opposed to the Germans, which relocated only certain elements of the production process, kept one part of value added in the country, and retained domestic skills and know-how, the French relocated the whole production process. This relocation means that products deriving from the relocated production are not included in the French export statistics. The main reason for the decline in competitiveness is not found in the decrease of price competitiveness, but in the non-price factors. The share of microenterprises is greater among French companies than among German companies, and these microenterprises are less suitable for export activity. As a result,

French exports are more concentrated than German ones. French companies offset their declining cost competitiveness in a way that decreasing profit was built in the export prices. At the same time, it had the consequence that the business sector had to restrain its R&D expenditures and investments and, therefore, these dropped lower than those of the competitors, which further deteriorated their competitiveness. The French government announced its National Pact for Growth, Competitiveness and Employment in 2012 and enacted a series of measures to stimulate innovation in the private sector. With the help of competitiveness clusters (*pôles de compétitivê*), the connection between the public and private research activities was strengthened. In the EU's innovation scoreboard, France is among the innovation followers. The World Economic Forum (WEF) Global Competitiveness Index (GCI) also shows that businessmen do not consider the business environment too friendly (ECFIN DG 2013e: 17–18, 27–30, 2014f: 36–38, European Commission 2014c: 5).

What makes fighting high unemployment more difficult is that the French labour market is highly segmented; there is a high degree of differentiation between outsiders and insiders, which unfavourably affects particularly the young and low-skilled workers. During the crisis, employers wanted to keep their employees by way of reducing working hours, and dismissals were accomplished mainly among employees with fixed-term contracts (Jany-Catrice and Lallement 2012). The proportion of workers with fixed-term contracts is not much higher than the EU average (in 2011, 15.1 and 14.1 per cent). However, the number who were able to switch from fixed-term contracts to open-ended contracts within a year was 14 per cent in France, 45 per cent in the UK, 29 per cent in Italy, and 23 per cent in Germany. In 2013, the social partners signed an agreement on the reform of the labour market, the aim of which was to take the labour market into the direction of flexicurity. They aimed to make it easier for, in times of economic difficulties, working hours to be reduced temporarily, and in order to save jobs, company-level and sectoral agreements can be modified. They also aimed to make individual and collective dismissals more flexible. Disincentives were built in, as opposed to short-term fixed-term contracts. Such measures and similar measures were intended to decrease the segmentation of the labour market. By contrast, 82.8 per cent of the contracts signed in 2013 were fixed-term contracts.

The labour tax wedge was the highest after Belgium; therefore, according to the provisions of the National Pact for Growth, Competitiveness and Employment, social partners have reduced the employment costs for the companies, which may have a beneficial effect on employment, as well as competitiveness. However, the high and indexed minimum wage has survived, which weakens flexible labour market adaptation. Furthermore, the success of labour market reforms has been jeopardised by institutional characteristics, namely, the weaknesses of labour relations. The difference in the extent of wage bargain coverage and that of trade union density was the greatest in France among the developed countries (95 per cent and 8 per cent, respectively, according to Eurofound (2014) data). Therefore, the representativeness of the trade unions was the lowest in France, and regardless of the decentralisation of the wage agreements, the collective agreements could be extended over all the sectors or regions, which could also be done by the government at the request of any of the negotiating parties. However, this is not the only aspect characteristic of labour relations' quality. Based on the index-gauging opinion shared by business leaders, the willingness to cooperate between employers and employees is rather poor in France—only Italy and Romania (within the EU) show worse results. According to the WEF Global Competitiveness Report (2013–2014), general behaviour has been assessed as 3.4 on a scale of one to seven (from confrontation to cooperation), which means that France ranks 135th out of 148 countries (ECFIN DG 2013e: 38–41; EC SWD 2014p: 19; OECD 2013d; Schwab 2013).

France is among those few OECD member states in which social inequalities measured by the Gini index did not grow between the mid-1980s and 2008. The high minimum wages have contributed to this result. The labour market situation, which has been deteriorating because the crisis could not be counterbalanced by the welfare provision, and the various indicators measuring risk of poverty and income inequalities have risen, but altogether, they are still below the EU average. As previously mentioned, the impacts of economic liberalisation beginning in the 1980s were compensated by a high level of welfare provision, even though means-tested benefits also appeared as part of this provision. High social spending was the main reason why general government expenditures exceeded 55 per cent of GDP in 2011 (only Denmark had higher figures

within the EU). Decreasing expenditures, which would affect social expenditures, is constantly on the agenda, but substantive measures have been taken only in relation to the pension reform. The generous pension system is an especially large burden if the government aims to accomplish a sustainable budget. In 2010, the government passed the decision on the gradual increasing of the retirement age and the restrictions on early retirement. The pension reform approved in 2013 will be able only to halve the deficit of the system by 2020. The maintenance of moderate income inequalities has been made more difficult by the fact that a dual system developed not only in the labour market but also in higher education. The problem has already arisen in public education: schools are not able to subdue the differences between the various social backgrounds, and the difference between pupils in terms of performance became worrisome at the end of the 2000s, in which the learning difficulties of pupils with migrant backgrounds play a part as well. In the fragmented higher education, the process of differentiation continues, and there is a gap between schools known as "*grandes écoles*" (which function in a selective environment, are financed favourably and are showing excellent results) and other higher education institutes (OECD 2013d; EC SWD 2014p: 15; Hemerijck 2013: 359–360).

According to the 2012 PISA report, French students' performance is average, while public spending on education only slightly exceeds the OECD average. In the education system—similar to many other European countries—the greatest efforts have been taken towards practice-oriented vocational training; nevertheless, the number of apprentices decreased by 8.1 per cent in 2013 (EC SWD 2014p: 22; OECD 2013j: 5, 2014b: 258).

During the crisis, the French institutional system took the same path as the country took in the course of the earlier reforms in the previous decades. The case of the Nordic countries and Germany confirms that strengthening competition, liberalising the financial and labour markets and enhancing cooperation between social partners can be pulled together—although sometimes with difficulties. However, in the French version of the continental model, the weaknesses of social partnership were compensated by the prominent role of the state. After weakening this outstanding role, the cooperation between social partners could not

provide as supportive a background to the competitive functioning of the economy as in the Nordic countries or in Germany. Amable et al. (2012) indicate that behind the difficulties of the French economy lies the change in the political background. The economic and social impacts of the reforms, which have been on the agenda since the 1980s, disturbed the balance of interests and, consequently, the compromise between the political right and left wings. No dominant social block that would be able to push the economic or social policy into the direction of a clearly neoliberal or social democratic/continental direction has developed since then. As a result of the crisis, the relations to the liberalised EU market and the views on the role of the state have become even more polarised. There was a flicker of hope that following the agreement between the social partners in 2013, there would be more cooperation between the partners, but after the socialist—but at the same time more market-friendly—Manuel Valls was appointed in March 2014, the differences became more acute, again. One thing seems to be certain: if France wants to maintain its competitiveness, the strictly market-based capitalism model—with all of its social consequences—can be avoided only if the country can strengthen the institutions built on the cooperation of the social partners in the economy and in politics because the absence of this cooperation can no longer be replaced by state interventions (Table 6.5).

6.3 Adjustment in the Smaller Continental Countries

The Netherlands suffered a 3.3 per cent decline in 2009 after the previous years of a 2.7 per cent average growth rate. The recovery of the economy has been slow; a modest boom was followed by contraction in 2012 and in 2013 (by –1.6 per cent and –0.7 per cent, respectively). Unemployment did not increase first compared to the pre-crisis period, but it was 5.3 per cent in 2012 and 6.7 per cent in 2013. Six–seven per cent is expected for the coming some years. This occurred in spite of the fact that the government allowed the automatic stabilisers to work, although due to the strict fiscal regulation, it should have decreased

expenditures, given that deficit was 2 per cent. The discretionary instruments applied in the fiscal package in 2009–2010 in the Netherlands amounted to 2 per cent of GDP, including tax reduction, infrastructural investments, and employment promotion measures—similar to the other countries. The Netherlands recorded a budget surplus in 2008 (0.2 per cent), but in 2009, it turned into a deficit of 5.5 per cent. The discretionary instruments were only temporary, they were originally planned to last until 2010 (OECD 2010i: 22–24). In 2011, fiscal consolidation began, and since then, the deficit has decreased—in 2013, it was 2.3 per cent. However, public debt, which was 42.7 per cent in 2007, has grown by more than 20 percentage points since the crisis, and it is expected to remain at around the level of 70 per cent in the coming years.

The analysis of the financial systems in Part II indicates that the financial sector plays an especially important role in the Dutch economic system. The greatest amount of claims is towards Germany, the USA and the UK, and the largest exposure is to Luxembourg, Belgium and Ireland, relative to the GDP of the borrowing countries. The Netherlands' international embeddedness is firm, and the presence of the banking system is quite strong in the domestic real estate sector as well, to which 30 per cent of all loans were provided. The international financial crisis brought the banking system to the brink of collapse in late 2008. Fortis Netherlands/ABN AMRO, which had been a member of a large international banking consortium, was nationalised. In 2010, Fortis Netherlands was integrated into ABN AMRO, and its name ended. After restructuring, ABN AMRO remained a Dutch state-owned bank, which can return to private hands via a stock market listing in 2015. The other large Dutch conglomerate, including ING, needed recapitalisation due to the losses suffered in the mortgage market of the USA. One of the four major banks, SNS REAAL Bank, was nationalised in February 2013. In addition to nationalisation and recapitalisation, the Dutch government also provided direct loans and government guarantees to support the financial system. The three major banks paid back half of the support received for recapitalisation by 2010. Recapitalisation and asset relief between 2008 and 2012 amounted to 4 per cent of GDP in 2012. The crisis of the Dutch banking system also resulted from the fact that the regulation, although in compliance with international requirements, was relatively lax compared to that of

many other countries, in terms of capital requirements, accounting and supervision rules, as well as bankruptcy procedures. The supervisory body functioning in the framework of the Dutch National Bank has already been strengthened, and the Financial Stability Committee has been established, but according to the experts of the IMF, further measures are needed to extend the entitlement of the Dutch National Bank (European Commission 2014g; OECD 2010i: 28–30; IMF 2013d: 12–14). The banking system was still large after the crisis; in 2013, total assets of the banking sector amounted to 373.6 per cent of GDP (EC SWD 2014ü: 46),[4] while at the same time, the banking system was very vulnerable as a result of mortgage debt and its dependence on wholesale funding. The high level of mortgage debt of households was attributable partly to tax deduction on mortgage interest and partly to the small, strictly regulated social housing market. Social housing has been enjoying subsidies and support since 1901, and therefore, social housing accounts for one-third of the housing market, which cannot be seen anywhere else in Europe. Since the mid-1990s, most subsidies have been abandoned, while social housing remained strongly regulated, which led to a substantial decrease in the construction of social housing, and home ownership was stimulated. Although between 2008 and 2013, housing prices decreased by 20 per cent, this happened continually and not suddenly; prices have stabilised since 2013. Due to their indebtedness, households did not have much savings—although the amount of savings increased during the crisis; therefore, substantial interbank funding was needed. Another reason for deposit funding gaps is that the two pillars of the pension system (the formally voluntary but practically mandatory second pillar and the voluntary third pillar) absorb many savings. The operational rules of the second, occupational pillar prescribe the funding ratio between the value of the assets and the net present value of nominal liabilities, which must be met. During the crisis, this funding ratio naturally declined; thus, premia had to be increased, which pro-cyclically decreased the income of the households and, consequently, the demand (ECFIN DG 2013g: 29–39).

At first sight, it may seem surprising that the Netherlands recorded current account surpluses, even in the years of the recession (hitting the lowest point in 2009 at 5.2 per cent) and that, since 2010, it has exceeded 6 per cent of GDP (exceeding the +6 per cent threshold of the

EU's excessive imbalance procedure). In order to assess this figure, several characteristics of the Dutch economy have to be taken into account. Net exports of natural gas constitute a factor adding to the surplus, accounting for approximately 1–2.5 per cent of GDP. The geographical location of the Netherlands (with the port of Rotterdam being a trade gateway to Germany) and the developed transport infrastructure and logistics sector have given a huge impetus to re-exports. In 1995, re-exports accounted for only one-third of the Dutch goods balance, while in 2013, it accounted for roughly one-half, contributing some two percentage points to the total current account surplus. The relative underperformance of domestically produced exports can be explained by the fact that they are dominated by foodstuffs, chemical products, and machinery equipment. The demand for these products is increasing more slowly than the demand for computers and electronic equipment in re-exports. The services balance has been positive since 2004 primarily because the Dutch legal and taxation environment is favourable to multinational companies; therefore, multinational companies are keen on setting up their global headquarters in the country. Moreover, multinational companies generate profits that are far above the EU average. Not all this income is retained in the Netherlands, however, because Dutch shares in foreign hands amounted to 55 per cent of GDP in 2011 (compared to only 20 per cent in Germany). However, the presence of multinational companies is a very important source of income and provides an explanation for the fact that the Dutch non-financial corporate sector has shown a persistent savings surplus. Moreover, profits repatriated by the foreign subsidiaries of Dutch enterprises accounted for 1.1 per cent of GDP in 2004 and 4.7 per cent in 2011. In the Netherlands, an increasing share of exports is directed to emerging markets, but due to the country's role as a trading centre, it is hardly surprising that three-quarters of its exports are still directed to the EU (more precisely, one-quarter of them is directed to Germany) (ECFIN DG 2014p: 21–28). The 9.5 per cent loss of export market shares between 2008 and 2013 befits the necessarily occurring and frequently mentioned trend characteristic of developed countries. The cost competitiveness of the Netherlands is not at risk, regardless of whether the evolution of ULC or that of REER is examined. Regarding non-cost competitiveness, the Netherlands is among the innovation

followers in the EU's scoreboard; its R&D expenditure is around the EU average. Business enterprise expenditures on R&D are a slightly below the EU average and concentrated on a limited number of multinational companies. The Dutch manufacturing sector has shifted towards the medium-high-technological products. Since 2012, the government has been running its enterprise policy featuring a sectoral approach to public-private partnerships involving the actors of the business sector, including the SMEs and research institutions with the aim to develop sector-specific policies and to encourage private investments in the area of R&D&I (EC SWD 2013k).

Hemerijck (2013: 183) presents the Dutch labour market as an example of how to manage to strike a balance between flexibility and the protection of the employees (the latter provided for employees with part-time and fixed-term contracts as well). The cluster analysis in Part II described the Dutch labour market as an individual case, that is, as a unique realisation of flexicurity. However, given the declining employment trend, EU experts warn of the duality of the labour market (EC SWD 2013k: 13). According to the index showing the EPL, protection for regular employment is the fourth highest in the Netherlands among the OECD countries, while protection for temporary employment is the ninth lowest (OECD 2013a: 273). The good performance of the educational system and, more precisely, the vocational education system results in low youth unemployment (11 per cent in 2013), although it has been on the increase lately, especially among the families with migrant backgrounds.

The ageing of society makes it necessary for the average number of working hours to be increased, which is otherwise relatively low. The main reason for this is that part-time employment is widespread among women. In order to make better use of labour potential, an agreement was made between the government and the social partners in April 2013. On the basis of this agreement, certain acts that entered into force in 2015 were passed. The EPL will be liberalised further, which is expected to decrease the duality of the labour market. The maximum length of time for which statutory unemployment benefits are paid will be gradually reduced from 38 months to 24 months, and there will be further measures to improve labour market participation and mobility. To this

end, schemes for people with disabilities have been reformed as well (EC SWD 2014ü: 20–22).

Due to the ageing population, the otherwise generous Dutch pension system had to be reformed. In addition, the crisis itself has produced austerity measures in the entire system of welfare provision as well. The coalition government of the Christian Democrats and Social Democratic Party could not push through its plans because the government fell in 2010 and because the Conservative Liberal minority government was in power only until 2012. In the spring of 2012, the caretaker government managed to push through a consolidation package, which was implemented by the Conservative Liberal government in coalition with the Social Democrats after the 2012 elections and was complemented with another. The austerity measures included several areas of welfare provision, but the most important changes were introduced in the pension system and in health care. In tertiary education, as of 2012, students are expected to fully finance their studies privately but can take low-interest loans from the government. The retirement age has been raised, and reforming the second pillar of the pension system is also on the agenda because the financial crises in 2000 and 2008 caused losses that crushed the ambitions that the introduction of the second pillar in the pension system would be enough to sustain the 70 per cent replacement rate (EC SWD 2013k: 18; De Deken and Maarse 2013: 13).

In the mid-2000s, several reforms were introduced in the Netherlands with the aim of shifting from government control to a market-based system of health care. However, the increase in costs could not be stopped. Health care costs (as a percentage of GDP) are among the highest in the OECD countries, while life expectancy at birth is similar to the Western European countries' average. According to the government's own assessment, the health care system is "stuck in the middle" between a centrally planned and a market-oriented system. The reforms introduced between 2010 and 2015 aimed partly to curtail the growth rate of public health expenditures and partly to enhance competition (De Deken and Maarse 2013; OECD 2012d).

The Netherlands belongs among those welfare states that have tried to make welfare provision sustainable with the help of marketisation for two decades. In addition to the processes described above, the share of

benefits received on the means-tested principle is high and increasing compared to other North-Western continental countries (4.7 per cent of GDP in 2011 [EC SWD 2014ü: 49]). In the field of social protection, at the end of a long and gradual transition, a unique combination of welfare and workfare elements, universal and selective social rights, and public and private expenditures has come into existence. During the crisis, obviously, the welfare, universal elements got pushed into the background and the workfare, selective elements gained ground (Yerkes and Van der Veen 2011). The impact of the changes that came into force in 2015 cannot be seen yet, but the results so far are ambiguous. The good news is that the Dutch society remained inclusive in nature. During the crisis, neither the risk of poverty indicators nor the indicators for income inequalities grew (Table A.8). At the same time, the total cost did not decrease compared to the other Nordic countries. The expenditures on social protection (in Eurostat data, public and private expenditures appear together) were high in 2011, accounting for 30.5 per cent of GDP (in comparison, in Sweden, it was 29.0 per cent of GDP, and in Denmark, it was 32.8 per cent).

In the first years of the crisis, the traditional tripartite solutions did not function smoothly, but altogether, the cooperation between the social partners remained strong according to the legacy of the "polder model", which is described in Part II. Trade union density is only approximately 20 per cent, but collective agreements cover more than 80 per cent of the employees. The number of company-level agreements has risen, but sectoral agreements are still dominant (EC SWD 2013k: 17; Eurofound 2014; Freyssinet 2010).

The Dutch students performed above average in the PISA tests in 2012 (OECD 2013j: 5). In the Netherlands, public expenditures on education were slightly above the OECD average, even during the years of the crisis, but within government expenditures, the share of education is decreasing. The government is planning to decrease the spending on education further, which means that further reduction can be expected relative to the GDP, as well as within government expenditures (in the case of the latter, it is will drop from 19.1 per cent in 2005 to 16.6 per cent in 2017). It remains to be seen what effect this will have on the quality of education (OECD 2014b: 258; EC SWD 2014ü: 10).

From the above, it can be seen that the Netherlands has several favourable structural and institutional features; however, the effects of the financial sector's consolidation and the mortgage debt accumulated in the households persistently slow down its development.

Belgium weathered a minor decline compared to the Netherlands in 2009; its economy contracted by 2.6 per cent. After the boom in 2010, growth was modest—similar to the other countries in the euro area—but Belgium's advantage of one percentage point against the Netherlands remains. It is anticipated that a growth of approximately 1 per cent will follow in the coming years, and thus, the gap may close, and the Netherlands may take the lead. The unemployment rate of above 7 per cent was not higher than it was before the crisis, and it has stabilised at a level above 8 per cent since 2013.

When Belgium prepared for the euro adoption, it continually decreased its public debt, which was reduced from above 130 per cent in the beginning of the 1990s to 86.9 per cent in 2007. In spite of the efforts that were taken for one and a half decades, this decrease meant a high starting level in the crisis, and the government introduced a moderate fiscal stimulus package accounting for 1.5 per cent of GDP in 2009–2010 (OECD 2009a: 10). Fiscal deficit was 5.5 per cent in 2009, and Belgium has been successful in maintaining this deficit at the level of 3 to 4 per cent. Public debt exceeded 100 per cent in 2011, and it is expected to remain at this level (100–110 per cent) in the coming years. Primarily, the large public debt and the costs of the ageing society (which are rising at a higher rate than the EU average) weigh heavily on the budget. In 2012, the old-age social security system was curtailed, and the rules pertaining to early retirement were tightened. The workfare system of unemployment benefits entailed savings in the budget as well. Minor austerity measures have always been on the agenda pertaining to health care and other social expenditures, but it seems that these measures will not be enough for long-term fiscal sustainability. This situation may remind us of the reforms of the 2000s, which had modest results (Hemerijck 2013: 187). Within the federal state, the spheres of authorities have been constantly changing; therefore, increasingly more complicated coordination has been needed, which made managing the budgetary processes more difficult. In 2012, fiscal federalism developed further in the framework of a reform known

as the "sixth reform of the state", and certain social expenditures and the related tax collection rights were given to the regions and communities. The majority of expenditures related to ageing have remained at federal level for the time being (OECD 2013c). The weakness of the federal state is well demonstrated by the fact that, following the 2010 elections, Belgium did not have an elected government for 589 days. In 2014, four and a half months after the general elections held on 25th May, the new government was formed on 11th October.

The restructuring of the banking sector substantially contributed to the increase in public debt. The assets of the Belgian banks amounted to nearly four times the Belgian GDP in 2008, according to the ECB database.[5] The three largest financial conglomerates (BNP Fortis, Dexia, KBC) experienced severe market pressures as early as the second half of 2008 and were in need of capital injections, partly due to their exposure to the US market and partly owing to individual reasons. For instance, Fortis suffered from a fragile balance sheet resulting from the acquisition of ABN AMRO (OECD 2009a: 18). The situation was critical, in spite of the fact that no real estate bubble evolved in Belgium, although housing prices were increasing rapidly and real prices has been stabilised since 2008. Neither the corporate nor the household consolidated debt put the banking system at risk. Recapitalisation and asset relief between 2008 and 2012 amounted to 10.7 per cent of the 2012 GDP (European Commission 2014g). The market position of the banks including KBC and BNP Fortis improved, and government subsidies were no longer necessary. The repayment of assistance schemes is on-going. Dexia proved to be a persistent problem: in 2011, it was split and subsequently recapitalised for a second time, and the Belgian and French banking arms were nationalised. The Belgian banks substantially decreased their exposure to foreign countries, especially to the Southern European public sector. However, the increasing Belgian government bond holdings pose further risk to the financial sector. Assets of the Belgian banks (60 per cent of which were foreign-owned) in 2013 hardly amounted to more than two and a half times GDP, and altogether, it can be said that the banking system stabilised. The supervision of the financial sector was reorganised in 2011: two centres, "twin peaks" of the banking supervision—the National Bank of Belgium and the Financial Services and Markets Authority—were set

up. The legal framework of financial supervision was tightened further in 2013 (EC SWD 2014l: 15–16; OECD 2013c: 16–17). The Belgian current account had deteriorated since the beginning of the 2000s, and its surplus of 5 per cent eroded to 1.9 per cent in 2007. During the crisis, the current account turned slightly negative, but it is expected to be in balance in the coming years. Between 2008 and 2013, Belgium lost 9.1 per cent of its global market shares, which is clearly the result of the increasing international trade activity of the emerging countries. These data in themselves do not give serious cause for concern; however, the background factors do indicate trends that may lead to a persistent loss in competitiveness. The deterioration in the current account was caused by the downward evolution of the goods balance, which could not be compensated by improving the services balance. There are a few factors that hindered the growth of Belgian goods exports. On the one hand, in the last decade, the share of capital goods in manufactured exports was below 10 per cent and that of intermediate goods was approximately 60 per cent. This means that there is a minus-ten-percentage-point difference in capital goods and a plus-ten-percentage-point difference in intermediate goods compared to Germany, France, or the Netherlands. At the same time, the demand for intermediate goods is increasing more slowly than the demand for capital goods. On the other hand, during the crisis, Belgian companies managed to direct the majority of their exports to the increasingly growing emerging countries; however, 70 per cent of Belgian exports are still oriented towards the EU member states. The third factor is the decline in cost competitiveness. This can be detected in the appreciation of REER, which had been on-going since the beginning of the 2000s and in which certain correction was performed during the crisis, but it was not enough to regain competitiveness (ECFIN DG 2014a: 17–21).

In Belgium, there are institutional constraints imposed on increasing non-cost competitiveness and cost competitiveness. The most important factor in non-cost competitiveness is technological competitiveness. In Belgian exports, the share of high-tech and medium-high tech products was 57.2 per cent in 2011, which is lower than their share in German or French exports (69.3 and 62 per cent, respectively) but similar to that in Dutch exports (56.7 per cent). The share of high-tech products in

Belgium was 18 per cent, which is similar to the German case (18.8 per cent) but lower than the French and the Dutch cases (26.2 and 27.3 per cent, respectively) (ECFIN DG 2013a: 25). Belgium's innovation performance places the country among the innovation followers in the EU's scoreboard (European Commission 2014c: 5), in compliance with the importance of the intermediate goods and with the fact that it is not the services related to the high-tech products that grow within the exports of services but rather the transport and business services. Belgian R&D expenditures are at the level of the euro area average. Since the beginning of the 1990s, the majority of the R&D policies have been decentralised among the regions, and as a consequence, the potential for synergies between the regions is lacking. The Walloon Region's innovation strategy is laid down in the document known as the "Marshall Plan 2022", while Flanders' innovation strategy is described in "New Industrial Policy". Two-thirds of the Belgian R&D expenditures are from the business sector, which is considered the optimal proportion; however, business R&D is indeed highly concentrated, and more than half of industrial R&D is realised by foreign-owned companies (ECFIN DG 2013a: 44–45; EC SWD 2014l: 21). These resources will remain intact only if they manage to keep the R&D activity of the companies in Belgium. Enhancing innovation is also important because Belgian export products should advance higher in the value chain from their present medium position in order to be able to maintain the higher wage costs.

Two factors erode cost competitiveness. The prices of certain intermediary inputs, such as energy prices and the prices of certain services on the market in which competition is weaker, are higher than in neighbouring countries. Recently, the evolution of wage costs has been less favourable than in the case of competitors. ULC has been growing more rapidly compared to Germany since the adoption of the euro and, since 2005, compared to the euro area average as well. In 1996, a centralised, coordinated wage bargaining system was introduced with the partial aim of maintaining international competitiveness. The wage increase determined as the result of this system is transferred to sectoral wage agreements, which cover more than 90 per cent of employees. The wage increase was adjusted to the expected wage increase of the major trading partners, and it was implemented in the entire country, regardless of the

regional and sectoral differences in productivity. The system functioned well in the beginning, but in recent years, the wage increase in the reference countries has been overestimated. In order to increase competitiveness, the calculation of the wage norm was changed in 2012, but the automatic indexation of wages survived, which made ex post correction more difficult if there were forecast errors (ECFIN DG 2013a: 20–21).

The crisis did not increase the unemployment rate directly, thanks to shortened working hours and other supportive measures; nevertheless, the unemployment rate crept over 8 per cent in 2010, and it is not expected to decrease in the near future. This rate is below the EU average, but it is higher than the German, Dutch, or Austrian levels. However, the protection of the employees with open-ended contracts is slightly below the OECD average, which theoretically presumes a labour market that is flexible enough. One of the reasons for the middling performance of the Belgian labour market is that the tax wedge on labour is still the largest in Europe. Additionally, in the above-described centralised wage bargaining system, there is not enough room to manage those huge disparities that still exist between the regions in terms of employment. In 2012, the employment rate was 58.2 per cent in the Brussels region and almost 65 per cent in the Walloon Region, while it exceeded 70 per cent in the Flemish region (ECFIN DG 2014a: 27–28). The disparities are not only geographical in nature. The employment of the low-skilled, the elderly, and those with migrant backgrounds is well below the EU average, while the general rate is close to the EU average. The impact of this phenomenon is reflected in the rising indicators of poverty, although these are still below the EU average. The indicators for income inequalities did not rise (Table A.8).

The labour market would function more efficiently if the education system reacted more adequately to the needs of the labour market. Education policy is in the hands of the regions, but neither the Walloon region nor the Flemish region has accomplished the reforms that were initiated in the fields of vocational training and adult education. The 2012 PISA report shows that Belgian students performed at an average level in sciences and at a higher than average level in maths and reading. Public spending on education was generous even during the crisis (more than 6 per cent of GDP) (EC SWD 2014l: 17; OECD 2013j: 5, 2014b: 258).

Trade union density is the highest in Belgium after the Nordic countries, exceeding 50 per cent. The tripartite system is invariably centralised, and the major employer and employee organisations cover the entire country. The sectoral agreements can be extended over all actors of the sector concerned under the authorisation of the legal regulation. During the crisis, the cooperation between the social partners became conflict ridden, and negotiations were hindered by the absence of a third party, that is, by a long period in which there was no government. The number of working days lost due to strikes increased, especially in 2011 (Eurofound 2014; Freyssinet 2010). Overall, social partnership remained functional, but the forms of social dialogue have not changed, and no adaptation to the changed environment has occurred. The indexed, centralised wage bargaining system, which was built on the wage norm, is no longer able to provide an adequate framework in an economy, the functioning of which is rather erratic territorially.

Although Belgium has an extensive banking sector, households have not become indebted, which means that Belgium has an advantage over the Netherlands in this respect. On the other hand, this advantage is counterbalanced by high public debt and territorial division; thus, the prospects for growth are very similar in the case of the two countries.

Luxembourg has proved to be an outlier case in the cluster analysis in terms of product markets, R&D and the financial system; therefore, it was not detailed among the models of capitalism when the empirical results were interpreted. Nevertheless, it is worth examining this country when creating an overview of the impacts of the crisis because Luxembourg—with a population of just over half a million—has a significant financial sector, and the stability of it is important for the whole euro area.

The crisis caused a 5.3 per cent decline, and, subsequently, growth changed in the same manner, as it fluctuated in the euro area. It is expected to remain around 3 per cent between 2014 and 2016. Before the crisis, the current account balance recorded on average a surplus of approximately 10 per cent of GDP annually (it reached 7.3 per cent even in 2009), and it is expected that the surplus will be around five to 6 per cent in the coming years. The current account surplus is large in spite of the fact that the trade balance of goods has showed a deficit (around 10 per cent) for decades; however, the exports of services counterbalance.

Luxembourg embarked upon specialisation in the services of banks, insurance companies, and investment funds in the 1920s, and the country has been dealing with this area since then, even when legal regulations became stricter in other countries. The size of the banking sector is demonstrated well by the data from the ECB database, according to which the assets amounted to 34 times the GDP in 2008 and 20 times the GDP in 2013, which is several times higher than the highest European figures.[6] In absolute terms, however, the assets accounted for EUR 736 billion in 2012, which is lower than the amount of assets in Belgium, not to mention the banking assets of the UK in the amount of EUR 10 trillion. The size of the insurance sector was four times GDP in 2012. Regarding investment funds, Luxembourg has an outstanding role globally. Luxembourg is the second-largest centre after the USA, where the fund industry regained steam after the sharp decline in assets (–24 per cent) in 2008. In 2013, this activity covered more than 3900 funds and over EUR 2.6 trillion in assets. Luxembourg's financial system weathered the crisis well, but it had to take part in the recapitalisation of several banking groups (DEXIA, Fortis, and ING), which consumed 5.9 per cent of the 2012 GDP. Nearly 90 per cent of banking assets are owned by international banking groups. For this reason, it was significant that the government's guarantee scheme covered deposits only in banks and subsidiaries but not in foreign branches. Nevertheless, the scheme accounted for more than 4 per cent of GDP. The inter-linkages of the banking system with the domestic economy were limited, and the small size of the domestic banking sector protected Luxembourg from adverse consequences. The profitability of the financial system has been declining since the crisis, which has been an especially enormous problem for Luxembourg because one-quarter of value added is generated here. So far, economic stability, low taxes, professional expertise and strict rules pertaining to banking secrecy have all contributed to the attractiveness of Luxembourg. The stability of the financial system has been advanced by the fact that, in tandem with the growth of the financial system, efficient financial supervision has developed. International pressure to prevent tax evasion at the time of painful fiscal consolidation has been growing since the crisis. Luxembourg, having seen the unavoidable change, in 2013, ended the transitional period of a 2003 EU directive and introduced

the automatic exchange of information in tax matters with competent government tax authorities commencing in 2015. If international regulatory efforts prove to be successful, income from the financial sector may become persistently lower (ECFIN DG 2014k: 30–35; European Commission 2014g).

Although Luxembourg is keen on adapting to the changing environment, and certain segments of the financial system (investment funds and private banking) have shown promising developments since the crisis, it is disadvantageous that the country's economy depends largely on the financial system. In Luxembourg, the real economy has the same problems as the Belgian economy, only their extent is greater: in exports, intermediary products prevail, more than 80 per cent of exports are directed to the EU, REER has appreciated, and ULC has grown more rapidly than in the case of major trading partners, in which automatic indexation has played a part in Luxembourg. In terms of competitiveness, it is not advantageous that the R&D expenditures of the private sector have fallen. In 2012, these expenditures amounted to 1.0 per cent of GDP, which could not be counterbalanced by increasing public spending. On-going reforms are aiming to enhance the cooperation between the public and private institutions in the fields of R&D. Luxembourg is an innovation follower in the EU's scoreboard; in 2014, Luxembourg took the lead in this group (EC SWD 2014v: 23; European Commission 2014c: 5). The high level of indebtedness of the private sector is not such a huge problem as it may seem at first sight. In 2012, the consolidated debt of the companies amounted to 260.6 per cent of GDP, which is attributable to the fact that multinational companies frequently use their subsidiaries in Luxembourg to handle intra-group financing operations (EC SWD 2014v: 12).

The employment rate is high, and the unemployment rate was 5.9 per cent in 2013, which is enviable compared to those of the other European countries. This good overall picture, however, masks several weaknesses. The supply of labour flowing into Luxembourg from neighbouring countries puts the local residents at a disadvantage. Automatic wage indexation, poor incentives to work, and strong EPL make the labour market relatively rigid (ECFIN DG 2014k: 27–28; OECD 2012c). The tripartite consensus-based decision-making, which had strong traditions

in Luxembourg, has functioned a bit erratically since the crisis. Trade union density is nearly 40 per cent. Wage bargaining is usually performed at the company level, but the sectoral agreements are important as well, the validity of which can be extended by the government to all actors of the sector—similar to the French practice (Eurofound 2014).

Public debt grew from the pre-crisis 6–8 per cent to 23.6 per cent in 2013, which is still quite low, but it is unknown when the trend will turn round. This generous social system cannot be sustained if there is not as much income flowing in from the financial sector as there was previously, not to mention the fact that the costs of ageing weigh increasingly heavily on the social system. The 2012 pension reform was limited and cannot provide long-term sustainability. As a result of the crisis, the proportion of those who are at risk of poverty has increased, but compared to the EU, this proportion is still low. There has not been any change in the indicators for income inequalities (Table A.8). The greatest difficulty Luxembourg must face in the field of education is that the ratio of students with migrant backgrounds is high. This may explain why students in Luxembourg performed under average on the PISA tests. Vocational education—especially for children in immigrant families—did not function efficiently, and the government tried to help with the introduction of the dual system (EC SWD 2014v; 19–20, OECD 2013j: 5).

Due to the changes that have taken place in the financial system, since the crisis, the provision of financial services has no longer produced as ample a source of income for Luxembourg as it did previously. Nevertheless, there have been no signs so far that because of the above factors, Luxembourg would be forced to radically change its economic structure or its international position.

When *Austria* was hit by the crisis, the country had experienced growth of approximately 3 per cent for half a decade, and its unemployment rate was 3.8 per cent. The crisis brought a 3.8 per cent decline, which is considered mild compared to the other EU member states. The unemployment rate changed to a smaller extent than GDP; it actually increased by one percentage point in 2009, compared to the year before. Austria's government responded to the crisis with two national stimulus packages between 2009 and 2010, including tax cuts, measures supporting the purchasing power of private households and infrastructural investments,

which amounted to 3.5 per cent of GDP (rising to 4.2 per cent of GDP if the similar measures by the *Länder* are taken into account) (Kaniovski and Schratzenstaller 2010: 350). The government deficit hit its highest point in 2009, at 5.9 per cent, and public debt exceeded 70 per cent. Although the government deficit already decreased to 1.5 per cent in 2013, the decrease in public debt was expected to begin only after 2014. Regarding long-term sustainability, the ageing population causes the most difficult problem to be tackled.

The greatest risk for Austria during the crisis was exactly the same as that which provided outstanding profitability in the previous almost two decades: banks with extensive operations in Central, Eastern and South-Eastern Europe. The foreign assets of Austrian banks amounted to 133 per cent of GDP in 2008, and the participation of the European post-socialist countries and Turkey exceeded 60 per cent of GDP. The crisis brought deep recession to those countries that were dependent on the influx of foreign capital, naturally exposing Austrian banks to risks. The Austrian government applied measures similar to those taken by other governments in order to stabilise the banking system. Two medium-sized banks were nationalised, one of the five largest banks (*Österreichische Volksbanken AG*) was partly nationalised, and the other banks also received capital injections. Recapitalisation and asset relief between 2008 and 2012 amounted to 3.2 per cent of GDP in 2012. The generous state guarantees also contributed to the fact that the financial sector was not really shaken by the crisis. Until 2013, banks did not pay back the capital they had received, but the nationalised banks were reorganised, and the privatisation process started. In the case of the nationalised *Kommunalkredit Austria AG*, because privatisation failed, its winding down was approved in 2013. The tier 1 capital ratio of internationally active banks was still lower than their competitors' ratio in 2012, in spite of this growth. In 2012, the *Oesterreichische Nationalbank* and the Austrian Financial Market Authority issued prudential guidelines in which it was required that the Basel III capital standards were introduced as early as 2013. For the banking subsidiaries operating in Central, Eastern and South-Eastern Europe, a non-obligatory reference value (110 per cent) was determined in terms of the loan-to-local stable funding ratio. Concerns at the beginning of the crisis did not become a reality, and deleveraging the Austrian

banks did not occur in the area. The exposure of the Austrian banks amounted to 66 per cent of GDP at the end of 2012, their local deposits increased, and the loan-to-deposit ratio decreased to 104 per cent. Certain rearrangement took place in the region, and the presence of the Austrian banks decreased in Ukraine, Hungary, and Romania, while their presence increased in the Czech Republic, Poland, Turkey, and Croatia. The ratio of NPL in the region was still on the rise in 2013, meaning that this region, which was invariably regarded as a key market for the Austrian banking system, poses further risks. In Austria, the increase in real estate prices has not caused problems for the financial system—although the increase in prices have accelerated recently; the problem exists rather because some households (25 per cent of the loans in 2012) took loans denominated in Swiss francs, whose value has skyrocketed (EC SWD 2014k: 13–14; European Commission 2014g; IMF 2013a: 11–12; OECD 2013b: 15–17).

The EU accession and the Eastern enlargement have transformed the economic relations of Austria. The export of goods and services in terms of GDP was only 34 per cent in 1995, and this ratio rose as high as almost 60 per cent until 2007. The percentage of goods within exports is more than 70 per cent. The outstanding significance of the export of goods correlates to the fact that industrial products play an important role in the foreign trade relations of Germany and the CEE EU member states, which are major partners of Austria. Austria managed to achieve favourable positions in the value chains that developed in this region with the leadership of the German industry. The structure of industry is well-diversified in terms of sectors and technology as well. The REER deflated by ULC has not appreciated since the euro was introduced, which also helped sustain competitiveness, and price competitiveness could be maintained. The growth of productivity continuously exceeded the increase in real wages. Similar to many other EU member states, competition is weaker in the service sector than in the industry sector, which is exposed to competition from international trade (Ragacs et al. 2011). Austria recorded a current account surplus of over 3 per cent before the crisis, but it remained in the positive during the years of the crisis as well. Austria was able to maintain its market share within the EU, the euro area; nevertheless, its share of the world market decreased by 17 per

cent between 2008 and 2013 despite increasing trade with certain emerging countries. R&D expenses also amounted to approximately 2.8 per cent of GDP in the years of the crisis, which is very close to the level of expenses represented by Denmark or Germany. At the same time, Austria is listed only among the countries that are classified as innovation followers by the Innovation Union Scoreboard, and the Austrian government's ambition for the future is to break into the group of innovation leaders. Unfortunately, this goal is impeded not only by the weak relationship between publicly financed research and the business sector but also by the low number of people with higher education qualifications (EC SWD 2014k).

Overall, it can be said that the integration of Austria was successful; it has contributed to the growth of the economy by adding 0.5–1 percentage points on a yearly basis since the 1990s. In addition to the large corporations privatised in the 1990s, the engine of the economy is the domestically owned, flexible, medium-sized enterprise sector. The latter is able to spread those technologies and organisational techniques that were originally introduced in large corporations. Medium-sized enterprises have gradually developed, their R&D activity is relatively strong, and their strength lies in manufacturing medium-level technological products. These entirely or partly family-owned enterprises give 75 per cent of employment. Until now, family ownership has not prevented organisational innovation, but it can be challenging that there will be a generation change in one-third of the companies in the next decade (Röhn et al. 2013: 35).

Labour relations in Austria are enduring; there is mutual commitment between employers and employees. EPL, in terms of employees with open-ended employment contracts, is at the average level of the OECD countries; that is, the labour market is flexible. However, this flexibility is occupational flexibility and is utilised mainly within the company; the mobility of employees is low. These features are not valid for all segments of the labour market because the employment of unskilled workers or workers with migrant backgrounds is lower. The rate of workers with fixed-term contracts is below the OECD average, but the related EPL is above the OECD average. One-third of women work part-time, and involuntary part-time employment remains low. The duality features of

the labour market can be found in Austria as well, but these features are less sharp than those in Germany or in France. Additionally, in Austria, an efficient step in adapting to the crisis was the shortening of working time. Employment is supported by their differentiated vocational education system. Austrian young people may choose from various levels of education, ranging from apprenticeship-based education, which consists of 20 per cent school education and 80 per cent practical training, through vocational colleges to the Universities of Applied Sciences. Social partners are active in running the vocational education system. Due to this system, the unemployment of the young was the lowest in the EU—together with the Netherlands and Germany—at approximately 7 per cent, even during the years of the crisis (Röhn et al. 2013: 38–40). The PISA report made in 2012 basically shows the average performance of the students, and this result was achieved in a way that public expenditure on education was only slightly higher than the OECD average. At the same time, participation rates in higher education are very low in all age groups, compared to the developed countries. Even in the youngest age group (25–34 years), there is only one European country, Italy, in which the rate of participants is lower (22 per cent) compared to the Austrian 26 per cent and the OECD average (40 per cent) (OECD 2013j: 5, 2014b: 44, 258).

The inequality indicators in Austria are below the EU average. The inequality and poverty risk indicators rose slightly in 2008. Although these indicators have decreased since 2008, they have never reached their pre-crisis level. Apart from some cost-cutting measures, no considerable institutional changes were implemented in the welfare system. Population ageing, however, puts huge pressure on the health care system and—in spite of the pension reform in 2003—the pension system; therefore, the possibility of early retirement has been limited since 2013. In Austria, the family, especially women, plays an important role in the social system (for example, only 12 per cent of children under the age of two are in institutional care), which means that women need to solve the very serious issue of finding a balance between family and work. Local communities act as support to the social services system; in Europe, Austrians are the most active in performing unpaid, voluntary work (EC SWD 2014k; Röhn et al. 2013: 41–42).

Although the system of social partnership weakened after the introduction of the liberal reforms and the EU accession, the cooperation between employers and employees remained strong in Austria, and the above-described changes were based exactly on this system. The year 2006 witnessed the grand coalition coming to power again, and it contributed to the revival of social partnership. Cooperation between social partners was especially important during the crisis, as they managed to avoid the increase in unemployment by shortening the working time. On the one hand, this cooperation was important from a social point of view, and after the crisis abated, the economy revived soon with the help of retained employees. The more decentralised approach in the case of the collective agreements during the crisis facilitated flexible adaptation. The state could again rely on the support of the social partners when it came to curbing the increased state expenses and making a return to the sustainable budget (Hermann and Flecker 2012). A slow but continuous change was always characteristic of Austria's adaptation before the crisis and during the crisis. Perhaps this is the reason why no other country managed to reconcile the otherwise contrary aspects of flexibility and stability, which have fundamental importance in well-being (Table 6.5).

6.4 Hybridisation, Layering, and Path Dependency

During the years of the crisis, the outlines of a new model could not be detected in the institutional changes of the North-Western countries. Instead, the categories of hybridisation, layering, and path dependency are more suitable for depicting what occurred. The changes are incremental; that is, they were superimposed on those changes that occurred in the 1990s, and groups of institutions have become even more hybrid than the models characteristic of the 1980s. The specific solutions of the individual countries, the speed and extent of the changes—as we have already seen—were considerably influenced by the particular path they had previously taken. This phenomenon is well known as path dependency.

Table 6.5 Changes in the institutional systems of North-Western continental countries after 2008

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Before 2008						
Liberalised, weaker competition in the non-tradable sectors	Innovation exceeding the EU average but the follower type of innovation system, with the exception of Germany	Highly developed banking system and shift towards financial market funding	Moderately liberalised labour market, the role of active labour market policies at the level of the EU average	Corporative institutions remain, their strength is weakened by the decentralisation of wage agreements	High level of welfare spending, status protecting pensions with significant weight	No strongly marked model
Characteristic institutional and regulatory features after 2008						
Germany						
Exports shifted towards fast-growing markets	No change: leading innovator	Regulation is becoming stricter, protracted reform of *Landesbanken*, exposure to the government bonds of the Mediterranean countries weighs on the banking system	Duality after liberalisation on the labour market	Decentralisation in wage agreements, strong cooperation between social partners	After minor austerity measures, certain groups received more advantageous pension benefits	Above-average PISA results, measures for developing higher education

France						
Exports shifted only slightly in the direction of fast-growing markets, weak competition in the non-tradable sectors	Innovation follower, decreasing R&D expenditure	Stable banking system, conservative business model, exposure to the government bonds of the Mediterranean countries, producing a great burden on the banking system	Further moderate liberalisation to decrease the duality of the labour market	Relationship is still burdened by conflict, weak cooperation between social partners	Minor austerity measures, partial pension reform	Average PISA results, reforming vocational training and the apprenticeship system
Netherlands						
Increasing re-exports, decreasing domestically manufactured products in exports	Innovation follower, business R&D is focused on few multinational companies	Making loose regulation stricter, continuous market correction of real estate prices	Further liberalisation to decrease duality in the labour market	Invariably strong cooperation between social partners	Minor austerity measures, pension reform including the second pillar, further marketisation of the healthcare system	Above-average PISA results, well-operating vocational training with low levels of youth unemployment

(*continued*)

Table 6.5 (continued)

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Belgium						
Exports shifted only slightly in the direction of fast-growing markets, weak competition in the non-tradable sectors	Innovation follower, business R&D is focused on few multinational companies, R&D policy is regionally decentralised	Regulation is becoming stricter, the size of the banking system decreases after restructuring	The central wage agreements do not follow the regional differences in the labour market	High levels of trade union density and cooperation between social partners	Minor austerity measures, partial pension reform	Above-average PISA results, regionally launched vocational training reforms
Luxembourg						
Exports are focused on the euro area	Innovation follower, R&D expenditures of the business sector have decreased	Regulation is becoming stricter, the financial central role remains, the size of the banking system has decreased	Rigidity of the labour market has not changed	Strong cooperation between social partners remained	Partial pension reform	Below-average PISA results, reforms in public education and in vocational training to help the integration of students with migrant backgrounds

Austria						
Integrated in the German and Eastern and Central European value chain, internationally competitive SME sector	Innovation follower, increasing R&D expenditure	Regulation is becoming stricter, the Eastern and Central European exposure puts a burden on the banking system in certain cases	Duality in the labour market, but less markedly than in the other continental countries	Invariably strong cooperation between social partners	Minor austerity measures, partial pension reform	Average PISA results, well-operating vocational training with outstandingly low levels of enrolment in higher education

Source: Author's compilation

Hybridisation seems to be the most appropriate term for characterising the changes because these changes cannot be defined either as an advance towards or as a withdrawal from the neoliberal model, which evolved in the 1980s. During the two decades preceding the crisis, the expansion of the neoliberal model remained one of the fundamental questions of institutional comparison. Adverse tendencies can be observed in the various institutional areas.

Before the crisis, the growth model that characterised primarily the UK and Ireland is usually associated with the USA and neoliberal thinking, that is, that economic growth is based on the securitisation of mortgages and, consequently, the indebtedness of citizens and financial innovations. These elements appeared outside of the North-Western countries as well, for example, in Denmark, Spain and the Baltic countries. These countries are still struggling with the consequences. In the financial sector, it became clear that wherever prudent regulation remained, smaller damages occurred. Germany's regionally organised publicly owned banks (*Landesbanken*) showed that not only extreme deregulation but also political influencing can cause damages. Particularly, huge losses were accumulated in those countries, where loose regulation went along with state-induced, political influencing, such as in Ireland and Spain (see details below). Making the regulation more strict and strengthening and reorganising financial supervision have become a general process coordinated at the EU level.

As far as labour relations are concerned—with the exception of the UK and France—the decentralisation of wage bargaining, the lessening of trade union density and the stabilisation of social dialogue took place, paradoxically, parallel to each other, as a general tendency. It seems that maintaining wage bargaining in a more flexible form, which is adaptable to rapidly changing market conditions, is in the interest of both parties. Social partnership in certain countries has explicitly contributed to successful crisis management (especially in Austria and Germany). In the Benelux countries, even if there were conflicts in the first years of the crisis, social partnership remained functional, just as in Ireland. It is true, however, that in the latter country, trade unions were in a weaker position. Approaching the issue from the other side, it can be seen that the conflict between employers and employees in France has clearly worsened eco-

nomic performance. In Belgium, the territorial division has hindered the successful operation of social partnership. In fact, all countries remained on the path on which they had been treading since before the crisis; either the positive or the negative effect of path dependency has asserted itself.

Due to turning private debt of the financial system into sovereign debt and other effects of the crisis, which reduced government revenue, austerity measures were introduced everywhere in the system of social services. The ageing of the population could not leave the pension systems of the countries unaffected. Each country has achieved reforms, with varied determination. No further marketisation took place in the provision of welfare benefits, with the exception of the Netherlands. Means-tested benefits are significant not only in the Netherlands but also in Ireland, the UK, and Germany (in 2011, 7.8 per cent, 3.8, per cent, and 3.4 per cent of GDP, respectively) (EC SWD 2014s: 45, 2014j: 39, 2014q: 41).

As opposed to the above-mentioned tendencies, which are controversial in terms of neoliberal institutional solutions, liberalisation definitely continued in the product and labour markets, and it has led to competitive disadvantages where further liberalisation has not taken place. It is true for each continental country (even where it has not been mentioned specifically) that in the network industries and in certain services, competition is more limited than in other areas of the economy. The large difference in the regulation of the tradable and non-tradable sectors causes palpable competitive disadvantages for the Belgian and French economies. Until now, in the literature of institutional analyses, little attention has been given to corporate structure, but the examples of Germany and Austria underline its significance. The SME sector, which is able to apply advanced technologies and develop these technologies further, as opposed to the excessively numerous microenterprises, is indispensable for international competitiveness.

As a result of liberalisation, which was implemented in a hotchpotch manner on the labour market in the continental countries in the 1980s and 1990s, a more or less dual labour market has evolved. The crisis amplified the difference between those who were employed with open-ended contracts and those with fixed-term contracts; the latter became the first victims of the lay-offs. In the case of employees with fixed-term contracts, in the majority of the continental countries, by reduction of the working

time, the labour force could be kept, which, otherwise, was not characteristic of the English-speaking countries. The persistent segmentation of the labour market causes obvious economic drawbacks. Differences in the legal status of the employees are usually dissolved everywhere by more flexible regulations, that is, by curtailing employment protection. Taking into account high youth unemployment, vocational training proved to be the most critical area of the educational system in this period. The introduction of dual training was generally seen as an educational messiah. It is not known what the future holds for the dual training having been abstracted from the German-Austrian institutional environment and whether it will live up to expectations.

The place of the English-speaking countries' institutional system among the North-Western countries cannot be defined unambiguously. It was exactly the financial system which gained particular importance and in which the UK deviates from the other North-Western countries the most. Nevertheless, the UK and Ireland still only partly meet the criteria of the ideal type that is usually described as a liberal market economy or the Anglo-Saxon model based on the institutional system of the USA. The relatively large size of the banking system, its significant role, the system of welfare provision and the state's responsibility in it differ from the ideal type of the Anglo-Saxon model; the innovation system is not a cradle of radical innovations. Therefore, these countries cannot be clearly, markedly separated from the other North-Western countries in the future, either. At the same time, the outstanding significance of financial services subsists in case of the UK; consequently, its unique position is preserved because it has deep historical roots, as shown in this chapter. It is not yet known how far the increasing Euroscepticism of its population and the planned restriction of the free movement of labour have drawn the country away from the EU and how these events influence its institutional system. By restructuring the economic system after the crisis, Ireland, which is in favour of social partnership and EU membership, may become more similar to the North-Western countries.

Luxembourg still stands out in terms of all categorisations; it represents a unique combination of an offshore centre and certain institutions of the old continental model (a rigid labour market and generous welfare benefits).

The category of the North-Western countries is still very heterogeneous, with the UK being the most detached country from the group. From Ireland through the Netherlands to France, the countries blend the elements of the liberalised and the traditional continental institutional systems in different proportions. During the crisis, the German and the Austrian institutions proved to be the most successful. In addition to the retained social partnership and the gradual and continuous institutional reforms introduced in the 1990s, the fact that in their economies, the weight of the financial services was lower and the weight of industrial export was higher than in the competitor countries also played a significant role in this success.

In the future, two processes will presumably run parallel to each other. On the one hand, the differences originating from countries' specific, individual development paths will survive in their responses to the common challenges (competition from emerging countries, the ageing population, and so on); nevertheless, the EU regulations, the reform programs and sharing of each other's best practices will encourage a slow and limited institutional convergence.

Notes

1. Michael Cohrs (Member of the Financial Policy Committee, Bank of England) cited Alan Greenspan in demonstrating the false presumptions of the system before 2008: "All of the sophisticated mathematics and computer wizardry essentially rested on one central premise: that enlightened self-interest of owners and managers of financial institutions would lead them to maintain a sufficient buffer against insolvency by actively monitoring and managing their firms' capital and risk positions" (Cohrs 2012: 2).
2. http://speri.dept.shef.ac.uk/2014/10/09/state-regions/ date accessed 10 December 2014
3. According to the online Eurostat database, data concerning public spending are also above 6%, while other sources publish data indicating public spending between 5.2 % and 5.9 % (EACEA 2013: 7).
4. In other analyses of the Committee, different data can be found about the size of the banking systems. According to ECFIN DG (2014p: 46), the

Dutch banking sector is 5 times the GDP (in the UK, it is 6.5 times the GDP). According to ECFIN DG (2014k: 31), the Dutch banking sector is 4.5 times the GDP (in the UK, it is 5.5 times the GDP).

5. According to the OECD (2009a: 18), the amount of assets was five times the GDP in 2008, and the reason for the discrepancy in the data is not known.
6. According to the European Commission's analysis of macroeconomic imbalances, total assets amounted to 17 times GDP in 2014 (ECFIN DG 2014k: 31), and other data concerning the other countries do not comply with the data downloaded from the ECB database, either, or with data in the appendices of the Commission's assessments of the national reform programmes. It would also require some explanation that in the 2013 assessment, the share of foreign banks in 2009 is 90.6 %, and in the 2014 assessment, the same (2009) piece of data is 64.7 % (EC SWD 2013i: 39, 2014v: 40).

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7

The Search for a Way Out in the Mediterranean Countries

Within the EU, the Mediterranean countries suffered most from the economic crisis, and the consequences have influenced the development path of the entire European integration. Since 2009, there have been few years in which these countries' economies did not contract, and from among Greece, Italy, Portugal, and Spain, public debt remained under 100 per cent only in case of the latter. Of the two small Mediterranean island countries, Cyprus and Malta, the former faced persistent difficulties.

7.1 Destruction of the Crisis in the Old Mediterranean Member States

The crisis in the Mediterranean countries has put the entire euro area at risk. In 2010, Greece, as a member of the euro area, received a loan from the EU and the IMF, and Portugal followed suit in 2011. In 2012, Spain received financial support for the recapitalisation of its banks through the European Financial Stability Facility, which was created as a temporary crisis-resolution mechanism by the euro area. Italy did not reach this

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point, but the country is facing a protracted crisis with persistently high unemployment. The weaknesses of these countries' institutional systems, which have been described in Part II, have already prognosticated that these countries are more vulnerable to external shocks (Table 7.1). Examining the driving factors of the crisis is important not only to confirm the above statement but also to examine how these countries' crisis management affects their institutional systems and economic potential.

The economic growth of Italy was not strong in the years before the crisis (Table 7.1), and even when the global economic environment was favourable between 1999 and 2007, Italy reached only 1.6 per cent growth, compared to 2.2 per cent for the euro area. This difference in growth increased during the years of the crisis; between 2007 and 2013, GDP decreased by 1.7 per cent in the euro area, while in Italy, it decreased by 8.7 per cent (ECFIN DG 2014j: 23). The Italian government did not have room for manoeuvring to alleviate the crisis because Italy's public debt had already been significant when the crisis began. In the beginning of the 1990s, Italy's public debt was 120 per cent of GDP, and in the run-up to euro adoption, it gradually decreased to 100 per cent until 2004. At that time, the decrease stopped in spite of the fact that Italy benefited from a radical drop in interest rates after the euro was introduced. In 2008, the public debt was 102.3 per cent, while in 2013, it increased to 127.9 per cent despite the fact that the Italian government—unlike those of the other member states—did not introduce a fiscal stimulus package. Although certain anti-crisis measures were taken in November 2008 and February 2009 (mainly for the benefit of the most vulnerable groups), these measures were offset by cutting costs or by increasing revenues (OECD 2009d). The decline in GDP and the operation of automatic stabilisers increased the government deficit to 5.3 per cent in 2009. As a result of the crisis of the other Mediterranean countries and Ireland, in Italy—which is known for its traditionally loose budgetary discipline—the financing cost of Italian government bonds increased. Although there are on-going austerity measures, Italian government debt is expected to exceed 130 per cent in the coming years (ECFIN DG 2014j: 22). In 2012, the balanced budget rule was incorporated into the constitution according to the EU requirements. The realisation of the budgetary discipline will be influenced largely by whether the Italian government man-

Table 7.1 Some of the major macroeconomic indicators of Greece, Italy, Portugal, and Spain 2004–2013

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment-volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T–1	Nominal unit labour cost index (2010 = 100)—percentage change T/T–1
Greece								
2004–2008 average	3.1	9.1	2.6	107.6	93.8	–14.2	0.5	2.4
2009	–4.4	9.6	–13.7	126.8	117.2	–11.2	2.4	7.4
2010	–5.4	12.7	–20.9	146.0	128.8	–10.1	–1.2	0.3
2011	–8.9	17.9	–16.8	171.3	130.6	–9.9	0.6	–0.2
2012	–6.6	24.5	–28.7	156.9	130.5	–2.4	–4.4	–3.3
2013	–3.9	27.5	–9.5	174.9	135.6	0.7	–0.6	–7.0
Italy								
2004–2008 average	1.1	7.1	0.9	105.0	102.2	–1.4	0.4	2.5
2009	–5.5	7.8	–11.7	112.5	120.1	–1.9	1.2	4.6
2010	1.7	8.4	–0.5	115.3	121.2	–3.4	–4.5	–0.1
2011	0.6	8.4	–1.9	116.4	120.4	–3.0	0.0	0.7
2012	–2.3	10.7	–7.4	122.2	120.8	–0.3	–1.9	2.1
2013	–1.9	12.2	–5.4	127.9	118.8	1.0	1.9	1.3
Portugal								

(*continued*)

Table 7.1 (continued)

2004–2008 average	1.2	8.4	0.1	67.8	179.0	–10.4	0.5	2.0
2009	–3.0	10.7	–8.6	83.6	204.2	–10.9	–0.6	2.7
2010	1.9	12.0	–0.9	96.2	201.5	–10.6	–3.1	–1.2
2011	–1.8	12.9	–12.5	111.1	204.2	–7.0	0.7	–2.0
2012	–3.3	15.8	–15.0	124.8	207.8	–2.0	–1.6	–2.9
2013	–1.4	16.4	–6.3	128.0	202.8	0.5	0.3	1.9
Spain								
2004–2008 average	3.1	9.6	3.7	41.1	171.8	–8.4	1.4	3.8
2009	–3.6	17.9	–18.0	52.7	202.4	–4.8	0.4	1.6
2010	0.0	19.9	–5.5	60.1	201.5	–4.5	–3.1	–1.6
2011	–0.6	21.4	–6.3	69.2	195.3	–3.7	0.2	–1.1
2012	–2.1	24.8	–8.1	84.4	184.8	–1.2	–2.4	–2.9
2013	–1.2	26.1	–3.8	92.1	172.2	0.8	1.9	–0.6

Source: European Commission (2013a), Eurostat

ages to achieve the necessary coordination of the government levels while fiscal federalism strengthens.

A unique feature of the Italian situation is that the banking system pulled through the crisis well in 2008–2009, partly due to its conservative business model and partly because there was no housing bubble in Italy. Therefore, the costs of restructuring and asset relief interventions (0.4 per cent of 2012 GDP) did not weigh heavily on the budget. However, in 2011, the sovereign debt crises of the euro area affected the Italian banking sector as well, and Italy began to lose access to international wholesale funding, increasing its cost. As a result, the banks were in need of the Eurosytem's[1] three-year long-term refinancing operations between 2011 and 2012. Furthermore, after foreign investors reduced their exposure to Italian sovereign debt, between 2010 and 2013, the stock of Italian government securities held by the Italian banks rose from 211 billion euro to 416 billion euro. The increase in NPL (15.1 per cent in 2013) worsened the profitability of the banking system and its ability to supply credit. The performance of the various segments of the banking system is very different. The performance of the top-5 banking groups is similar to their European competitors, but the numerous small banks with high density in their branch networks have modest performance only. The entire banking system is influenced by the ownership structure that evolved in the 1990s. The capital of privatised banks was taken over by non-profit foundations, and the banks were obliged to gradually sell their controlling interests. Nevertheless, 30 per cent of the banking system is still under these banks' control, and 4 out of the top-10 banks exercise influence exceeding the level of their actual ownership. This means that internal accountability is weak within banks' management and that the interests of the individual members prevail. Writing off bad loans is slow, partly because of the lengthy judicial process and partly because the market demand for distressed assets is limited. Altogether, the experts in the IMF and the EU agree that banks have strengthened their capital position, but due to low profitability and the weaknesses of the real economy, Italy remains vulnerable (EC SWD 2014t: 51; ECFIN DG 2014j: 19–21; European Commission 2014g; IMF 2013c: 27–29).

The greatest problem of the Italian economy is not in its financial system but rather in its weakening competitiveness in the real economy.

There was a small surplus in the current account balance after the euro was adopted, but in 2002, it turned into a deficit, and only in 2013 did the Italian current account balance return to a surplus. The severity of the problem is demonstrated well by the fact that Italy's loss of export market share was 18.4 per cent between 2008 and 2013, and this decline of export volumes and export market share has been on-going since 1999 (with the exception of one or two years). The structure of exports has not changed much since the mid-1990s; in 1996 and in 2011, the share of high-tech Italian exports was 10 per cent, while that of medium-high-tech goods was 39 per cent. The share of medium-low-tech products increased from 18 per cent to 25 per cent at the expense of low-tech products (ECFIN DG 2014j: 27). Regardless of whether either ULC or ULC-deflated REER is taken into account, cost competitiveness decreased because productivity growth lags far behind the euro area average. The nominal compensation per employee is in line with the euro area average. Between 1995 and 2007, the growth of real GDP per hour worked was 0.46 per cent *vis-á-vis* 1.2 per cent in the euro area (Crafts and Magnani 2011: 19), and this gap remained during the years of the crisis. Since 2011, wages have been moderated; public wages have been frozen, and the other non-tradable sectors have also experienced moderate wage dynamics. Wages in the more productive tradable sectors still increased. Real wage adjustment was performed through a reduction in hours worked, and in the first phase of the crisis, companies tried to keep their employees. The dismissal of employees began in mid-2011, when the economy again fell into recession. The integration of the Italian companies in global value chains is relatively limited; the share of foreign value-added in Italian exports is the lowest among the European countries, only partially because the proportion of small-size companies is large. The unfriendly, bureaucratic business environment and inefficient public administration hold back inward FDI, which would assist integration into the global value chain. Italy's investment rate is not insufficient in terms of quantity; thus, the moderate growth in productivity is explained rather by low technology absorption and the weakness of its innovation system. Italy recorded shares of ICT investment similar to France and Germany only until the mid-1990s. Rent seeking also contributed to the fact that capital flowed more massively into sheltered non-tradable sec-

tors; thus, non-tradable sectors gained ground against the tradable sectors (ECFIN DG 2014j: 37–38). In the Innovation Scoreboard of the EU, Italy is among the moderate innovators during the crisis as well. The latest Regional Innovation Scoreboard shows that there have been changes at the regional level. In 2004, the region of Piemonte became a member of the Regional Innovation Followers for the first time (on the basis of the data of 2010), in addition to two other Northern Italian regions (Friuli-Venezie Giulia and Emilia-Romagna), while the other Italian regions remained in the group of the regional moderate innovators (European Commission 2014e). According to Italian experts, in the mid-2000s in district economies, in the case of medium-sized enterprises, structural changes, internationalism, and outsourcing began to take place, and the crisis put an end to these processes (Simonazzi 2012). This standpoint is confirmed by the improving innovation performance experienced in the Northern regions of Italy.

Since the 1990s, deregulation has exacerbated the segmentation of the labour market in Italy, which has led to a dual labour market. Despite modest economic growth, employment opportunities have widened somewhat, which has been termed "growthless job creation"; new jobs were available through temporary contracts, and pay was low. The entry wage for young people aged 21–26 in 2002 reverted to the level of 20 years previously. This change led to a high rate of young people cohabiting with their parents, delays in forming a family and an extremely low fertility rate (Simonazzi 2012: 185). Employment reduction hit temporary workers first. According to Eurostat data, the unemployment rate of young people aged 15–24 climbed from 20.3 per cent to 40 per cent between 2007 and 2013. This figure fails to express the large underlying inequalities between certain parts of the country. In 2011, in the South, the employment rate of young people aged 15–34 was 31.7 per cent, compared to 56.5 per cent in the rest of the country (Simonazzi 2012: 190). This also means that wage moderation was more significant during the crisis than shown by the average data because people with lower wages fell out of work to a greater extent. In 2012, an important labour market reform was adopted which—by way of improving the exit flexibility for employees with open-ended contracts—addresses the rigidity

of the labour market and introduces disincentives to the use of temporary and atypical contracts (EC SWD 2013h).

In 1993, the social partners and the Italian government signed a tripartite agreement on the system of wage indexation and on the company-level distribution of productivity gains. Due to the large differences in productivity in various parts of the country, the latter was an important element of flexible adaptation. In 2009, 2011 and 2012, these parties concluded new agreements that decentralised collective bargaining even further and simultaneously widened the possibilities for diverting from the national agreement. Nevertheless, there was a severe split between the trade unions: the main left-wing trade union confederation, the General Confederation of Italian Workers (*Confederazione Generale Italiana del Lavoro*), refused to sign the agreements and organised strikes and demonstrations in 2009. Fiat played a major part in concluding the new, company-level agreements because bargaining took place under threat of relocation to Serbia and Poland (Freyssinet 2010; Simonazzi 2012). Ultimately, in 2013, all involved parties could agree upon the trade unions' representativeness at both the sectoral level and the firm level.

The Italian authorities estimated that in 2008, the shadow economy accounted for approximately 17 per cent of GDP and that undeclared work accounted for 12.2 per cent of all employment (EC SWD 2013h: 24); in an international comparative study, Italy's shadow economy is estimated as 21 per cent (Schneider and Kearney 2013: 4). Due to tax evasion, the tax base is limited, which decreases revenue from taxes, and as a consequence, it is impossible to reduce the tax burden (as large as the Belgian one), which weighs heavily on labour.

The budgetary austerity measures reduced welfare expenditures, which—due to the contraction of GDP—have grown anyhow in relative terms and exceeded 29 per cent between 2009 and 2011. In Italy, pension expenditure (16 per cent of GDP)—which is one of the highest in the EU—has not changed compared to the earlier periods. The pension reform in 2012 intended to restrain long-term growth in age-related expenditures by increasing the retirement age (EC SWD 2013h: 16, 25). In these circumstances, the share of people at risk of poverty or social exclusion (Europe 2020 indicator of poverty) increased by 3 percentage

points (Table A.8). The severe material deprivation rate increased from the pre-crisis 6 to 7 per cent to 12.4 per cent in 2013.

Econometric simulations also indicate that the weakness of human capital plays an important role in explaining Italy's productivity gap. The labour market in Italy values seniority more than education or skills. Although the last decade saw the share of the population aged 25–34 with less than upper secondary education decreasing, their share was still the fourth highest in the EU in 2012. By contrast, the share of the population with tertiary education was the lowest in the same year. The PISA surveys indicate that Italy's performance is below the OECD average; moreover, they demonstrate that there are huge regional inequalities, with the Northern regions having scores well above the OECD average (ECFIN DG 2014j: 39–41). The 2012, labour market reform attempted to support the transition from education to work for young people by modernising the apprenticeship system. In 2012, an agreement was concluded with Germany to foster cooperation on work-based learning in vocational education and training (EC SWD 2013h: 25).

The economic growth of Italy continues to be hindered by the weak performance of its government and public administration. In the WEF Global Competitiveness Report, Italy's ranking is between 139th and 143rd of the 144 countries in terms of public trust in politicians, the burden of government regulation, and the transparency of government policymaking (Schwab 2014: 223). The consequences of these factors can be seen in the absorption of Cohesion Policy funding. In May 2014, Italy, Slovakia, and Bulgaria absorbed less than 60 per cent of the EU funds available for the 2007–2013 period (European Commission 2014d: 175).

Spain arrived at the threshold of the crisis after a decade of rapid growth: between 1997 and 2007, the rate of growth was below 3 per cent in only one year (2002). It seems that Spain was successful in mastering fiscal discipline and managed to control its government deficit after the euro was introduced; moreover, between 2005 and 2007, it built up budget surpluses. As a consequence, public debt continually decreased, hitting the lowest point in 2007 at 35.5 per cent. The deepening imbalance of the current account indicated that the Spanish data do not result from a sustainable growth path. At the beginning of the 2000s, the deficit was

approximately 3 per cent—which is only natural and sustainable in the case of a catching-up economy—and later, it increased to 10 per cent by 2007. The first shock of the global crisis was relatively well tolerated by the Spanish economy; the contraction (–3.6 per cent) was smaller than the EU average. The slow recovery was yet again followed by a decline of approximately 1 to 2 per cent in 2011–2013. The economy was expected to grow again in 2014, and above 2 per cent growth was foreseen for 2015.

Due to the considerable surpluses built up in recent boom years, the Spanish government had room for manoeuvring to react to the crisis with a fiscal incentive package. In 2008, the government tried to stimulate the economy by way of tax reduction and, in 2009, by public investments—these measures amounted to almost 2 per cent of GDP in each year (OECD 2010h: 60). In addition to these measures, due to the operation of automatic stabilisers and the revenue slowly coming from the continually shrinking economy, government deficit jumped to 11 per cent in 2009 and decreased to 6.8 per cent from approximately 10 per cent only as late as 2013. Public debt was already 92.1 per cent in 2013, and it is expected to creep up to 100 per cent by 2015.

The international financial markets lost confidence in Spain and were concerned with whether the country would be able to pay back its increasing debt. The Greek crisis also cast a shadow on Spain. The year 2010 saw a considerable leap in the Spanish government bond yields, forcing the Spanish government to implement austerity measures. In addition to increasing taxes, there was a 5 per cent decrease in wages for public employees in 2010 and freeze in 2011, the indexation of pensions was abolished, and the state infrastructure expenditures were decreased (Éltető 2011: 46). Similar to those in the other Mediterranean countries, these measures indicated the beginning of a multi-annual series of austerity measures. In 2012, public expenditures related to health care, education and active labour market policies and expenditure on public employment had decreased. Nevertheless, the actual figures are found to be a bit worse than expected; thus, newer and newer measures have to be taken. The institutional framework of the budget has been strengthened. The supply and assessment of data were made more frequently, which was of utmost importance because of the independence of the regions

in enabling budget execution. In 2013, an independent fiscal institution was established to issue reports and opinions about the financial and macroeconomic situation (EC SWD 2014ö).

The expansion in the construction and services sectors is considered the driving force behind the Spanish recovery. As early as 1995, gross value added in construction was 12 per cent in Spain, which was approximately twice the EU average. The factors behind this situation are far more complex than simply the decrease of interest rates related to the introduction of the euro. In Spain, the demand for private housing was initiated under the Franco dictatorship, with the deliberate intention of social pacification. The labour-intensive construction industry and the development of infrastructure in the country's economic policy served the purpose of compensating for the losses suffered in agriculture and industry and absorbing unemployment after the EU accession. These processes were harnessed by two powerful lobbies (one linked to housing and construction and the other to banking)—of which the origins can be traced back to the Franco era—and the construction of houses was facilitated by government measures. Tax relief was granted by the government on the purchase of houses, while the subsidies for renting were eliminated. Corrupting the local politicians, lands have been reclassified, and as a result, it became possible to construct new houses in green areas, especially along Spain's Mediterranean coastline. The housing stock was not small in the first place compared to the number of residents, and a considerable portion of investments were second properties, often holiday homes (Dellepiane et al. 2013). It must be added that the huge wave of immigration received by Spain also contributed to the larger boom in the housing market (Gonzalez and Ortega 2013). Housing prices increased twofold in real terms between 1995 and 2008, but due to the crisis, the housing bubble burst. Between 2007 and 2013, housing prices fell almost by half in real terms, and this process ceased only in the last quarter of 2013. After the housing bubble burst, 700,000 houses remained unsold, and their number is decreasing slowly (ECFIN DG 2014n: 15–16; Éltető 2011: 43; OECD 2012f: 51).

Similar to other countries, the banking sector in Spain also contributed to the housing bubble. A considerable amount—two-thirds, according to 2011 data (OECD 2012f:56)—of loans to real estate developers and

builders was given by local savings banks (*cajas*), which were often under the influence of regional politicians. Political control and poor supervision led to extremely risky lending practices (Dellepiane et al. 2013). The major commercial banks, which had been managed professionally and more prudently and had expanded their operations abroad, mainly in the EU and Latin America, were able to more easily manage their portfolios, which were worsening due to the loans to real estate development, even after the outbreak of the global crisis (Neal and Garcia-Iglesias 2013). In 2009, when the government became aware of the challenges that savings banks had to face, the Fund for the Orderly Restructuring of Banks (FROB: *Fondo de Reestructuración Ordenada Bancaria*) was established, for which 75 per cent of the capital was provided by the central government, and the remainder was provided by the funded deposit insurance entities set up by the incorporated banks. The FROB supported the recapitalisation and merger of savings banks, and the legal provisions reduced the ceiling on voting shares of public administrations from 50 per cent to 40 per cent, as of 2010. Moreover, the new law also stipulated that in the governing bodies of savings banks, the representatives of municipalities should be elected by their assemblies rather than by the government (OECD 2010h: 41–43). When the crisis deepened, the Spanish banking system assumed a very difficult position after wholesale bank funding had fallen sharply, and the financing available through the Eurosystem was not enough, either. At the request of the Spanish government, in July 2012, Eurogroup provided a support package in the amount of 100 billion euro through the European Financial Stability Mechanism within the framework of an 18-month programme, out of which 41.3 billion euro was actually used. The programme successfully came to an end, and the changes in the system of the savings banks continued: after the mergers, only 12 savings banks remained out of 45. Privatisation of the state-owned properties resulting from the fiscal consolidation is advancing as well. An asset management company—mainly owned by private entities—called SAREB (*Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria S.A.*) was established, to which troubled assets were transferred from the banks. Surveillance of the banks was strengthened. The cost of recapitalisation and asset relief between 2008 and 2012 amounted to 8.4 per cent of the 2012 GDP (European

Commission 2014g). The Spanish banking system has been stabilised; however, it remains fragile, which is demonstrated rather well by the fact that the ratio of NPL was still increasing (13 per cent) at the end of October 2013 (European Commission 2014b: 14). The reduction of private sector debt accelerated at the end of 2012, largely due to the business sector. The savings and investments of households were well balanced until the beginning of the 2000s; however, households became increasingly indebted due to the loans required for housing purchases (ECFIN DG 2014n). The private sector stock of debt reached its highest peak in 2009, when it amounted to 202.4 per cent of GDP in consolidated terms, and the Spanish private sector became one of the most indebted members of the EU. By 2013, this debt decreased to 172.2 per cent of GDP in consolidated terms.

Regarding one of the key indicators reflecting the external imbalance of an economy—the current account balance—the same process can be observed as in case of the other member states of the EU in a similar position. As a result of declining exports and increasing exports, there was a rapid adjustment implemented during the crisis, and the country ran current account surpluses in 2013. However, if we examine the competitiveness of the Spanish economy, the picture is more complex than in the case of Portugal or Greece. Labour productivity in Spain grew more slowly than in Portugal or Greece—it was below euro area average: between 1999 and 2003, its annual rate was 0.3 per cent, and between 2004 and 2008, it was 0.5 per cent. By contrast, the compensation of employees per head grew by 3.0 per cent and 4.4 per cent, and ULC increased by 2.8 and 3.8 per cent annually in the periods concerned. These figures are higher than the euro area average or the EU average, which means that the price competitiveness of the Spanish economy has declined, while—due to the inflation—real compensation of employees per head was 0.0 per cent between 1999 and 2003 and 0.8 per cent in the years immediately preceding the crisis. Moreover, REER deflated by ULC appreciated by 0.9 and 2.9 per cent, respectively (European Commission 2013a: 15–16, 19). In case of all Mediterranean countries, it is often put forward that the appreciation of the euro and increasing energy prices contributed to the declining competitiveness. However, this

does not change the fact that the main problem is to be found in the modest growth of productivity.

The Spanish case also followed the Mediterranean scenario in that manufacturing declined rapidly: its share was approximately 20 per cent of GDP in the 1980s, but it was only 12 per cent of GDP in 2010. Concurrently, an evident shift could be observed towards the non-tradable sectors. This similarity is also reflected in that there is a large share of low-skill industries, and the share of technology-driven sectors is considerably smaller than that of the EU-15. However, the export structure—in terms of factor input and labour skills—is rather similar to the EU-15 average, and in this respect, the Spanish economy is different from the Portuguese and Greek economies (Aiginger 2013: 30–40). Concerning the technology content of products, although the share of high-tech products is low and price competitiveness declined, Spain's export market share remained stable: more stable than those of the major economies within the euro area (with the exception of Germany) (ECFIN DG 2012d: 29). Several factors made this possible. On the one hand, product specialisation was directed to the products for which prices grew more rapidly. On the other hand, ULC in the exporting firms did not increase at the same rate as in the economy as a whole, and these firms were more productive. Export activity is very concentrated in Spain—only 1 per cent of firms account for two-thirds of goods exported. Third, there was a sort of geographical diversification—the EU-15's share in total Spanish exports decreased between 2000 and 2010 from 71 per cent to 63 per cent, and Spain increased its exports to the BRIC and Middle Eastern and North African countries. At the same time, the import content of exports moved from 27.6 per cent in 1995 to 39 per cent in 2007, which indicates the poor competitiveness of domestic producers but also shows the increasing integration of the Spanish economy in the global value chain (ECFIN DG 2012d: 30). During the crisis, REERs and ULCs fell; thus, there was a recovery in price competitiveness. The export base is widening, and the number of exporting firms has grown steadily since 2008 (ECFIN DG 2014n).

For the recovery of economic growth, it is essential to increase productivity. In Spain, the corporate structure is not favourable in this respect. The average size of the Spanish firms is below the average size of

firms in the EU-15 countries, and the weight of the micro-enterprises is larger in all sectors, with the exception of the construction sector (Mora-Sanguinetti and Fuentes 2012). Spain has made considerable progress towards liberalisation in terms of product market regulation, even in the network industries, which improved the business environment in the last one and half decades. The law on the guarantee of market unity, which aims to address regulatory fragmentation in the Spanish internal market, came into force in 2013 (EC SWD 2014ö). Spain was a moderate innovator, according to the innovation scoreboard in 2014, following Italy and the Czech Republic. In 2012, Spain's R&D expenditure was 1.3 per cent of the GDP. Due to the crisis, the intensity of R&D expenditures decreased; moreover, the number of companies operating in the high- and medium-high-tech industries declined as well (Bielawska and Vázquez 2013). There are huge differences among the Spanish regions in terms of innovation performance, and it is difficult to bridge this gap by innovation policies adjusted to the regions (EC SWD 2014ö).

The situation in the labour market is a critical issue from the aspect of increasing productivity and competitiveness, as well as from a social aspect. Spain has been fighting the problem of unemployment for a long time; in the 1990s, the rate of unemployment was approximately 20 per cent, and as the result of economic growth, Spain managed to bring it down to 8.2 per cent, which was the lowest point, in 2007. The supply side of labour has increased as, gradually, more women and the massive inflow of immigrants enter the labour market. The explosive development of the construction sector made it possible for the low-skilled to find jobs. The demand for flexible employment was met by the application of fixed-term contracts, which led to the most extremely dual labour market within the EU. At the beginning of the 2000s, one-third of the working population was already employed in this way, while the EU average was approximately 13–14 per cent. The rate of unemployment increased rapidly and steadily during the crisis, and by 2013, it reached 26.1 per cent, while youth unemployment reached 55.5 per cent, which was surpassed only by Greece. Unemployment rates are dramatically high in Spain, partly because firms did not apply working time reduction—as done in many other countries—and partly because fixed-term contracts made it possible to dismiss employees. All this was closely related to the bust in

the construction sector, where low-skilled workers were employed mainly in fixed-term contracts. Managing the issue of youth unemployment is made more difficult by the fact that during the boom of the construction sector, there was a rise in the relative wage of low-skilled workers and a decrease in the skill premium, which attracted many to choose working instead of studying (Dolado et al. 2013). According to the estimation of Schneider and A.T. Kearney (2013: 4), the size of shadow economy is 19 per cent—the same as in Portugal—although Portugal's position is significantly more favourable in terms of the labour market.[2] In 2010, a labour market reform was implemented in several steps, which weakened the employment protection of the employees with open-ended contracts in order to decrease the duality of the labour market (OECD 2012f).

An important element of the labour market reforms was that the framework of wage bargaining changed, and as a consequence, labour relations changed as well. Companies are allowed to opt out from sectoral-level—previously the dominant level—agreements; thus, wage bargaining shifts towards companies. Trade union density weakened in Spain as well; in 2010, it was 16.4 per cent. Trade unions objected the labour legislation reforms of the left-wing Zapatero and those of the centre-right party (which won the general elections in November 2011); therefore, two general strikes were called in 2010 and 2012. In the meantime, in February 2011, a tripartite agreement was concluded for the pension reform and active labour market policy. In addition, in February 2011, the agreement for employment and collective bargaining was signed by the employers' and employees' organisations (Eurofound 2014).

The crisis slowed down immigration, but it could not stop it—especially immigration from poorer countries. Even when job opportunities began to decrease, the majority of immigrants did not choose to return to their countries of origin: those groups remained in a greater number and were socially more adaptable, including immigrants from Romania, Morocco, Ecuador, and Columbia, as opposed to Bulgarian immigrants, for example (Ródenas et al. 2013). The unemployment rate was higher among those with migrant backgrounds, and their employment remains a persistent challenge because the construction sector will not be able to absorb the size of the labour force it did before the crisis.

Fiscal consolidation curtailed welfare provision in Spain as well. The effect of the crisis is well demonstrated by the fact that the severe material deprivation rate increased from 3.6 per cent (in 2008) to 6.2 per cent in 2013. The other indicators for poverty and social inequality increased as well (Table A.8). The pension reform brought about restrictive changes, limiting the costs related to the ageing population by increasing the retirement age from 65 to 67 years old and by changing the method of calculating pensions (Banyuls and Recio 2012).

Spanish students performed below average on the PISA tests, but this is not the only indicator of the fact that the Spanish education system needs further strengthening. Labour market needs are not met by either tertiary education or vocational training, which also contribute to the dramatically high rate of youth unemployment (in addition to the driving factors of the crisis and the above-detailed characteristics of labour market institutions). Spain, as a response, has attempted to make some progress by implementing dual vocational training (EC SWD 2014ö).

Portugal was one of the few relatively less prosperous EU member states that could not gain much from the convergence successes of the 2000s. Its modest 1.2 per cent growth between 2004 and 2008 was not followed by a dramatic decline in 2009; the economy shrank by 3 per cent, but as of 2011, a three-year continuous recession followed. Presumably, 2014 was the first year when growth was approximately 1 per cent. The Portuguese economy tolerated the first shock relatively well because the economy was relatively closed, there was no real estate bubble and there was no considerable amount of toxic assets in the banks. A significant consolidation was performed in the budget between 2005 and 2007, after the deficit had crept up slowly to 6.2 per cent by 2004 following the introduction of the euro. In the 2009 elections, the left-wing managed to be re-elected, and these politicians' promise during the campaign was kept: after many years of a wage freeze, the wages in the public sector were increased. A stimulus package was approved as well, including tax reduction, social and employment assistance, and other forms of subsidising economic activities. Due to the impacts of automatic stabilisers, the deficit jumped to 9.8 per cent in 2009, and in 2010, it jumped even further, to 11.2 per cent. Public debt had been increased slightly but monotonously from 50.3 per cent in 2000; during the crisis, it soared, reaching 83.6 per cent

in 2009. The interest rate of government bonds increased significantly, partly due to the weak growth prospects and partly because there was an increasing mistrust towards the Mediterranean countries. At the beginning of 2011, banks reported serious international financing problems. In April 2011, the government required external financial help and then resigned. The elections in June 2011 were won by the opposition (Reis 2013).

The troika and the Portuguese authorities approved the Economic Adjustment Programme in May 2011 (European Commission 2014h). In return, Portugal received external financing in the amount of EUR 78 billion. One-third was financed by the European Financial Stabilisation Mechanism, another third by the European Financial Stability Facility, and the remaining third by the IMF. EUR 77 billion of this amount was duly utilised. According to the assessment of the troika, Portugal successfully completed the programme on 17th May 2014 (European Commission 2014h: 7). A special field of fiscal consolidation was that public-private partnership projects had to be renegotiated and made transparent because Portugal was the highest user relative to GDP, especially in the case of road construction—in 2011, accumulated investment in these projects accounted for 9.5 per cent of GDP (OECD 2012e: 64). In 2010–2011, the pension funds of the telecommunication companies and banks were re-routed to the general social security system. The pension funds of the banks accounted for 3.5 per cent of GDP. In addition, there was a wide range of austerity measures, including common devices: reducing wages and staff in the public sector and limiting public services and welfare provision; that is, two-thirds of the measures were on the expenditure side and one-third on the revenue side. The fiscal framework and planning were strengthened in May 2011, in line with the European fiscal framework, and an independent Fiscal Council was set up (OECD 2012e: 20–24). Due to the persistent problems related to fiscal discipline, stabilising the institutional background is of utmost importance in Portugal. Having modest growth prospects in view, government deficit may sink below the Maastricht benchmark of 3 per cent by 2016, and public debt is slowly decreasing from the 128 per cent observed in 2013. The austerity measures could not end here, especially because the Constitutional Court annulled certain provisions in 2012, and their

fiscal impact had to be offset. Fiscal adjustment in 2014 included further reduction of the public-sector wage bill and a pension reform, notably increasing the retirement age to 66 years (EC SWD 2014x).

The Portuguese banking sector—similar to the other Mediterranean countries—covered the gap between domestic savings and credit demand from the international financial market. On the threshold of the crisis, household debt was 80 per cent of GDP, and corporate debt was approximately 130 per cent of GDP. Although Portugal has the highest housing stock (compared to its population) after Spain in the OECD area, most of these houses are owner-occupied dwellings as opposed to tenures. Eighty per cent of debts were household debts; nevertheless, no housing bubble developed. As a result of the recession, housing prices decreased to 83.5 per cent in 2013, compared to the year 2010. Portuguese banks had the fourth-highest credit-to-deposit ratio within the EU, but it seemed to be manageable until 2010. Due to the breakdown of wholesale market funding and the exposure to Portuguese government securities, in 2010, Portugal needed to receive assistance from the Eurosystem, then, in 2011, from the EU and the IMF. In 2013, 10 per cent of the assets of the eight largest banks originated from the above-listed international sources. Bank deleveraging is assisted by the fact that their deposits have been increasing since 2012. Their capital ratios are satisfactory, but their profitability is weak. In 2013, the top eight banks had an aggregate loss of approximately EUR 1.9 billion (EC SWD 2014x: 16; OECD 2012e: 85–86, 94–95).

Before the crisis, in addition to facing sluggish economic growth, Portugal faced massive twin deficits. The current account deficit exceeded 10 per cent every year beginning in 2005, and only in 2012 did it decrease to 2 per cent due to shrinking internal demand and recovering exports; in 2013, an almost steady state was achieved. The problems related to competitiveness, which are so characteristic of the other Mediterranean countries, can be found in Portugal as well. The increase in productivity was only 0.9 annually between 1999 and 2003, and 1.1 per cent annually between 2004 and 2008, exceeding the euro area average by 0.1 percentage point in each case. This means that productivity per working hour was 63 per cent relative to the EU-27 average, and it could not change from this level. The annual 4.5 and 3.2 per cent increases in wages in these

periods meant that ULC increased by 3.5 and 2 per cent in these periods, respectively, significantly exceeding the euro area average. Inflation was higher in Portugal; thus, the real compensation of employees increased only by 1.4 and 0.4 per cent, however, this was higher than the euro area average; REER deflated by ULC appreciated by 1.7 and 0.6 per cent (European Commission 2013a: 15–16, 19).

The non-price factors of competitiveness show similar problems as those we have seen in the case of Spain or those to be described in the case of Greece (see below). The industrial sector shrank in Portugal as well, and its contribution to GDP decreased from the level of approximately 20 per cent in the 1970s and 1980s to 12 per cent in 2008. Low-tech products (products of the textile, leather and footwear industries) are dominant in industrial production and, as a result, in exports (Aiginger 2013: 30, 37, 40). In the medium-low-tech product market, Portugal lost market shares because of the competition from the CEE countries. In exports, the ratio of goods and services was approximately 70 and 30 per cent in 2008 and in 2013, respectively, which means that it is not possible to persistently improve the current account balance without improving the competitiveness of industrial products, even if the balance of trade for services indicates a surplus. Portugal suffered a loss of market shares mainly against the developed EU member states (with the exception of Spain), and the improvement of its position outside the EU was due primarily to trading with its former colony, Angola (OECD 2010f).

The question has been raised by many: how could it be that, although imbalances had accumulated in Portugal, growth was not as large as in the case of Spain or Greece. Portuguese public debt was lower than Greek debt, but the debt of the households and companies was higher (Table 7.1); that is, a huge amount of capital flowed into the country. Another frequently given answer to the mystery of the modest growth is that the Portuguese currency was overvalued when the euro was adopted. However, as Reis (2013) points out, this argument is weakened by the fact that no correction was performed later, either, and the appreciation of REER was continuous until the crisis. Experts generally agree that in the background of the modest growth of productivity, the declining competitiveness and the appreciation of REER, there has been a shift in the structure of the economy towards the non-tradable sectors of low productivity,

while the growth of productivity within the sectors was low. The data concerning the labour productivity of the entire economy are made even worse by the especially low performance of agriculture (OECD 2010f). Among the explanatory factors, we have to take into account that the skill level of the Portuguese labour force is low (more details are provided below). Large dispersion among company-level labour productivity shows that even inefficient companies can survive. On the basis of this fact, Reis (2013) draws the conclusion that the domestic financial system was not developed enough to allocate capital from the integrated financial market efficiently. A further explanation is that, due to regulatory constraints and insufficient competition, excessive rent attracts entrepreneurs to invest in non-tradable sectors. In the framework of the Simplex programme—as part of the adjustment—measures were taken in order to improve the business environment. Nevertheless, no breakthrough has been achieved in the allocation of loans (OECD 2012e). Liberalisation of the product market is shown by the fact that the indicator created by the OECD methodology decreased from 1.7 (2008) to 1.3 (2013) (EC SWD 2014x: 42).

During the five years of the crisis, a certain extent of correction took place in competitiveness. ULC decreased, REER depreciated, and price competitiveness strengthened. Exports began to increase: after the loss of export market shares of the previous years (during the five years preceding 2013, it was 15.7), in 2013, there was a 7.7 per cent growth. Portugal also succeeded in diversifying exports geographically towards the rapidly emerging countries: Angola, Algeria, Brazil, and China. It was also successful in improving the composition of exports when transport vehicles were given greater emphasis (OECD 2012e). The stock of inward FDI has been on the increase since the crisis hit its lowest point; in 2012, it was 55 per cent of GDP. The improvement of the innovation system is essential for persistent progress. Portugal is a moderate innovator, according to the innovation scoreboard in 2014, assuming 18th place between Spain and Greece. In 2010, Portugal's innovation performance approached the EU average, with 79 per cent, but during the crisis, this fell back to 74 per cent in 2013 (European Commission 2014c: 64). In 2012, 1.5 per cent of GDP was spent on R&D; half was spent by the public sector and the other half by the business sector.

In the decade before the crisis, the Portuguese employment rate was over 70 per cent, which was far better than the EU average. At the same time, the unemployment rate also increased, reaching 8 to 9 per cent in the pre-crisis years. Moreover, the rate of long-term unemployment also steadily increased. The rigidity of the labour market was one of the strongest within the EU, which led to the development of the dual labour market. The ratio for those employed in fixed-term contracts was more than 20 per cent, well over the EU average. In 2009, the labour code introduced several changes; nevertheless, Portugal overtook only Spain, France, and Greece in terms of labour market rigidity. The crisis caused huge destruction in the labour market: the employment rate sank below 65.4 per cent in 2013, the unemployment rate increased to 16.4 per cent, and the rate of youth unemployment reached 38.1 per cent. The mean unemployment duration almost doubled; in 2011–2012, it was 17.5 months (Carneiro et al. 2014: 446). In 2011, new reforms were launched, the labour market was further liberalised, and the difference between the degree of protection offered to employees with open-ended contracts and that offered to those with fixed-term contracts decreased. Unemployment benefits were curtailed in order to stimulate employment, and these benefits were made more easily accessible to the young, who would not have been entitled to such benefits under the same conditions as older people. The relatively high guaranteed minimum income was frozen, and as a result, it was expected that low-skilled workers would be employed more easily. Low-skilled workers account for a considerable segment of Portuguese economy, and they lost their jobs first. The rigidity of EPL was still above the OECD average, even after the reforms (Baglioni and Mota 2013; OECD 2012e). Altogether, it can be said that Portugal has made huge strides in restructuring the labour market institutions. The impact of such measures is difficult to assess in the midst of the recession. In 2014, a small decrease in unemployment was expected.

The Portuguese mechanism of wage agreements was detrimental to employment as such, as well as to competitiveness. The Portuguese Ministry of Employment extended the agreement concluded by the trade unions and employer associations to an entire sector, regardless of the representativity of the participating organisations. Thus, coverage of collective agreements exceeded 90 per cent. The agreements deal with the

minimum wages, not the anticipated wage growth. Furthermore, there was a pressure from the sheltered sectors—including the public sector—aiming at wage increases in the labour market (Carneiro et al. 2014). In 2011, the Socialist government froze the extension of wage agreements as part of the international rescue package. However, the new, Conservative-Liberal government implemented the measures, abandoning the expansion of the agreements and expanding the opportunity to conclude company-level wage agreements. The number of collective agreements has declined dramatically since 2011, mainly at the branch level, and the ratio of employees covered by agreements was 43 per cent according to the estimations of the Ministry. This process weakens the trade unions, the density of which has been declining for a long time—similar to other countries; it is estimated to be approximately 20 per cent. As a result of the austerity measures in 2011, the two trade union confederations organised general strikes, but in the meantime, one of them, the General Workers' Union (*União Geral de Trabalhadores*), with members mainly from the banking sector, public utilities and large corporations, signed two agreements in the framework of the tripartite negotiations in March 2011 and in January 2012. Since then, no agreement has been concluded; the standpoint of the government and that of the trade unions became too distant from one another (Eurofound 2014). Nevertheless, both employer and employee organisations have been undergoing a restructuring process in the past few years to achieve concentration and coordination in the fragmented and competing interests groups (Baglioni and Mota 2013).

The Portuguese system of social assistance shares the common characteristic features of the Mediterranean countries. The difference is that the employment of women is more extensive; therefore, the system is not as family based. In Portugal, the monitoring system for supervising the use of social welfare benefits is stricter than in the other Mediterranean countries (Baglioni and Mota 2013). During the crisis, the decline in wages and pensions and the increasing taxes severely tried Portuguese families; substantive adjustment began only in 2011. Until then, poverty and inequality indicators had even shown an improvement compared to the years before the crisis. In 2013, a 2-percentage-point deterioration can be seen for the EU poverty indicator and the indicator for the

severely materially deprived. Among the inequality indicators, the GINI index did not increase, but the income quintile share ratio did (Table A.8). Due to the guaranteed minimum income, which was introduced in 1997, the ratio of those unemployed poor people who do not receive social assistance is lower than in Italy, in Greece or in Bulgaria, but it is still 42.3 per cent. At the same time, the income threshold for eligibility of the minimum income scheme was lowered in 2010 and again in 2012 (EC SWD 2014x: 19).

The legacy of the dictatorship in Portugal can still be traced in the education level of the population. In 2009, 30 per cent of the people aged 25–64 had upper secondary education, compared to the OECD average of 73 per cent. During recent, decades there has been substantial progress, but catching up is slow, even in the younger generations. The ratio of people who have attained upper secondary education in the age group of 25–34 years (who were born during democracy) is only 60 per cent of the OECD average. The PISA 2012 study shows that Portuguese pupils' performance was average in mathematics, but it was below average in science and reading—the tendency of gradual improvement shown in the previous period has ended. During the crisis, tertiary attainment improved, increasing from 21.1 per cent in 2009 to 29.2 per cent in 2013, although it remains below the EU average of 36.6 per cent. The most substantial reforms in recent years were performed in vocational education and training. Portugal also wants to enhance practical, "on-the-job" training by involving companies (EC SWD 2014x: 20; OECD 2012e: 28).

Greece has proved to be the weakest link in the euro area. In relation to the Greek crisis, the risk of the disintegration of the euro area appeared together with the fear that a potential Greek national insolvency would bring down the other vulnerable Mediterranean countries as well; as a consequence, all European economies would be involved in a severe crisis. Therefore, more attention has been paid to the Greek situation than what would otherwise be reasonable in the case of a country with a population of 11 million.

As summarised in Part II, the Greek economy had been growing during the period prior to the crisis, but this growth was due to factors that were not sustainable. The average growth between 1996 and 2008 was nearly 4 per cent, and it dipped below 3 per cent only in one year,

2005. Recession began in 2008, with –0.4 per cent, and it hit the lowest point in 2011 and 2012, with a contraction of 8.9 per cent and 6.6 per cent, respectively. It is uncertain when the growth rate will turn positive permanently.

Imbalances in the system were forecast by a twin deficit; in 2006, the current account deficit as a percentage of GDP reached double-digit levels, creeping up to 15 per cent by 2008 (but it had been moving between 6 and 8 per cent in the preceding period), and the balance was disturbed in the mid-1990s. Public debt had always been approximately 100 per cent in the prime of economic growth; it decreased by a few percentage points only before the euro was introduced. After 2000, there were only two years when public debt was a double-digit figure and not a triple-digit figure. During the crisis, it soared dramatically, reaching 175 per cent in 2013. In the second half of the 1990s, there were efforts to reduce the deficit, but in reality, the deficit never sank below the Maastricht benchmark of 3 per cent. Data supplied in relation to the adoption of the euro in 2001 were found to be misreported, and the European Commission repeatedly expressed its concerns to the Greek authorities regarding the reliability of data. Greece was subjected twice (in 2004 and in 2009) to the excessive deficit procedure. The first procedure was abrogated in 2007. In March 2009, the European Commission found out—as the result of a data revision—that data concerning 2007 and approved by Eurostat were not real either; thus, the abrogation of the procedure was a mistake (Visvizi 2012). Additionally, the lack of trust that emerged in connection with Greece as a result proved to be fatal during the crisis.

Greece survived the initial shock fairly well because its exports to the Balkans were quite strong in 2008 and its economy was relatively closed; however, the Greek economy had slowed down a bit in 2007 due to internal imbalances. In 2009, Greece's GDP shrank by 4.4 per cent, which was on par with the EU average. At the same time, in 2009, when elections were held, the deficit soared to 15.2 per cent due to the non-limited expenditures and plummeting tax revenue. There were several steps until this figure was "created" at the end of 2010. The left-wing government, which won the elections (and raised objections about the austerity measures of the Conservative government earlier), declared in October 2009 that the anticipated deficit would be approximately 11–12 per cent of

GDP, much higher than that forecast by its predecessor. At the same time, the Solidarity Fund was established, from which allowances in the amount of EUR 866 million were disbursed to people with low incomes in 2009. Having the high and uncertain size of deficit in mind, the Greek borrowing opportunities deteriorated dramatically. The austerity measures announced for 2010 could not restore credibility. On the advice of the leaders of the euro area, who were not really prepared to manage the crisis, Greece required financial aid not only from the EU and the ECB but also from the IMF in April 2010 (Visvizi 2012: 21–22). The framework of the first package (covering the period of 2010–2013) was EUR 110 billion, of which EUR 52.9 billion was paid by the euro area member states and EUR 20.1 billion by the IMF. Because the 2012 national elections failed to give definite authorisation to any of the political parties and because the coalition was forming rather slowly, the payment terms of the package were not fulfilled on time, and in order to maintain stability, a second package—in the amount of EUR 130 billion—was agreed upon in 2012. Under the second programme, the remaining amount from the first package was disbursed; in April 2014, EUR 139.9 billion from the European Financial Stability Facility and EUR 8.3 billion from the IMF were disbursed. The entire amount up to the end of 2014 was expected to be EUR 164.5 billion. In 2012, the private sector had to take part in restructuring the Greek debt—government bonds in the amount of EUR 200 billion were exchanged (EC SWD 2014r: 5).

The Greek government introduced very strict deficit-reducing measures as early as 2010 (9.1 per cent of GDP), including tax increases (5.5 per cent) and budgetary saving measures (3.6 per cent) (OECD 2011b: 43). Deficit decreased by 6 to 7 percentage points, but due to the steadily declining economy and the high interest rates—in spite of increasingly newer austerity measures—deficit soared to 12.2 per cent in 2013. A substantial fall in the deficit was expected in 2014.

Greek banks did not have toxic assets and had adequate capital; therefore, they survived the first wave of the global financial crisis in good condition. The Greek case is unique; while, in other countries, losses occurring in the banking system were transformed into sovereign debt through the government-driven restructuring of banks, in Greece, the indebtedness of the government weighed heavily on banks. At the

end of 2009, Greek banks had a stock of government securities in the amount of 23 per cent of GDP, which is much higher than in the other Mediterranean countries (OECD 2011b: 57). In restructuring public debt, Greek banks also took part in the Private Sector Involvement programme, and according to estimates, they suffered a loss amounting to EUR 37.7 billion (20 per cent of GDP). Deposit outflows, closure of the interbank market, and the subsequent dependence on the Eurosystem all led to rising funding costs, and the suddenly increasing amount of NPL (as a consequence of the crisis) imposed a further burden on the economy. Mainly with the help of the international rescue packages via the Hellenic Financial Stability Fund (temporarily established for this purpose), the capital base of the four core banks was restored in 2012. One core bank went under government control, but the other three retained private management. Private investors became entitled to buy all government-held shares at a predetermined price at regular points in time over the next four and a half years. The healthy units of the non-core banks will be absorbed by the core banks; thus, the concentration of banks increases (OECD 2013e). The total cost of restructuring amounts to 19.2 per cent of 2012 GDP (European Commission 2014g). The share of NPL was still increasing; in 2013, it amounted to 31.3 per cent. Borrowing by households and by the corporate sector increased dynamically in the mid-1990s (at the same time, savings decreased), especially after the euro was adopted. Nevertheless, Greece started from a low level, and its level of debt was lower before the crisis than that of most OMS. Real estate investments increased dynamically as well, together with housing prices, but no housing bubble developed. As the economic situation deteriorated, demand naturally decreased, and a continuous price correction took place. Housing prices decreased to 73.4 per cent in 2013, compared to the year 2010.

The competitiveness of the Greek economy before the crisis was not in line with the increase in the standard of living characteristic of the 2000s. At the cost of the above-described imbalances, per capita GDP reached 95 per cent of the EU average in 2004. As a result of the crisis, per capita GDP decreased to 73 per cent in 2013. During the five years of the crisis, Greece suffered a 27.3 per cent loss in export market share by 2013. The problems of competitiveness derive from price or cost

factors and non-price factors. Greece achieved an annual 3.4 per cent growth in productivity between 1999 and 2003 and an annual 1.1 per cent growth in productivity between 2004 and 2008, which exceeded that of the other Mediterranean countries and the other OMS, but the 6.8 per cent and 3.5 per cent growth in the compensation of employees per head in both of the two periods, respectively, outperformed the euro area average. Consequently, nominal ULC increased as well by an annual 3.3 and 2.4 per cent, respectively. After 2004, the growth in productivity slowed, which meant that productivity per working hour again dropped below 80 per cent of the EU-27 average. The growth in real compensation was not too high; it was 3 per cent between 1999 and 2003 and 0.1 per cent between 2004 and 2008, as Greek inflation was higher than the euro area average. In these periods, REER appreciated by 0.9 and 0.8 per cent, respectively (European Commission 2013a: 15–16, 19). The fact that, in Greece, profit margins were maintained at a higher level than in the case of the partners in the EU contributed to the deterioration of price competitiveness (Alexiou and Nellis 2013).

It is even more important that as far as non-price factors are concerned, Greece's performance is weak and that there are severe structural problems in the background. The contribution of the Greek manufacturing industry to GDP is 8 per cent, which is outstandingly low compared to the EU member states. Moreover, low-tech products are dominant. The same can be detected in the structure of exports, and large corporations are less concentrated among the exporters compared to the other EU member states, which may be the consequence of the average small corporate size. In Greece, shipping and tourism account for more than half of the exports of goods and services, in which there is growing price competition (OECD 2011b: 34–35). In accordance with the above, Greece—as a moderate innovator—ranks 19th in the Innovation Union Scoreboard 2014. Total expenditures on R&D were 0.69 per cent of GDP in 2012, of which business expenditures on R&D reached 0.24 per cent of GDP (EC SWD 2014r: 16).

Measures taken as part of crisis management restored cost competitiveness. Wages decreased by 25 per cent (not only in the governmental sector), and the real compensation of employees per head did not reach 80 per cent in 2013, as it did in 2000. REER deflated by ULC returned

to the level present at the end of the 1990s. Greece's price competitiveness has not improved nearly as much as its cost competitiveness. Perhaps this is the reason why exports recover slowly. Although Greek imports declined, the substantial current account deficit returned to balance only in 2012. During the fulfilment of the terms and conditions of the rescue packages, several measures reduced red tape, strengthened competition, improved tax collection and may have had beneficial effects on the business environment in the medium or long term. Nevertheless, the indicator for product market regulation is still above the OECD average, even after the reforms (OECD 2013e). According to the WEF competitiveness index, Greece advanced from the 96th place to 81st place in 2014 (Schwab 2014: 13). It remains to be seen how persistent and profound the effects of the reforms—which have been dictated externally—will be. Tax evasion is an issue often mentioned in relation to Greece. In 2008, 64 per cent of all Greek taxpayers declared income below the tax-free income ceiling (Karamessini 2012: 164). Although Transparency International's Corruption Perception Index has shown slight improvement, Greece ranked 69th in 2014: last among the EU member states together with Bulgaria, Italy and Romania. According to OECD estimates, if tax collection efficiency had been similar to the OECD average, in 2011, the level of Greek government revenues relative to GDP could have been 6 percentage points higher (OECD 2013e: 24). In contrast, Schneider and A.T. Kearney (2013: 4) estimate the size of the Greek shadow economy in relation to GDP to be 24 per cent, which is not excessively high compared to the NMS.

State-owned companies contributed considerably to the Greek public debt: in 2011, there were more than 180 of them. In 2009, the loss generated by state-owned companies amounted to 0.7 per cent of GDP, which was partly due to their weak managements and partly to the level of wages, which was 1.5–3 times higher than the wage level in the private sector. Privatisation undertaken as part of the rescue packages progressed reluctantly, in which slow preparation, ambiguous legal issues and modest demand took part as well (OECD 2011b: 94; Visvizi 2012: 19–20; Visvizi 2013).

The Greek labour market reform was launched at the end of 2011. In the framework of this reform, the protection of the employees was loosened, the minimum wage decreased, the flexibility of working time

increased and wage bargaining was decentralised. Non-wage labour costs were reduced, which was necessary because, due to the relatively high minimum wage, companies tried to avoid employing young and unskilled workers. At the same time, a considerable proportion of employees were registered with minimum wages, thereby avoiding paying the progressive income tax and social security contribution. Due to the different tax rules, self-employment was an attractive option, especially for skilled middle-class professionals. As a result, the employment rate was low compared to the EU, and the number of hours worked per employee was high (Mitsopoulos and Pelagidis 2009, 2011a). As shown above, the decrease in labour costs indicates that the reforms were successful in making the labour market more flexible. Nevertheless, in a shrinking economy, where a large part of those 150,000 employees who were to be laid off in the public sector until 2015 also appeared gradually, even a flexible labour market failed to absorb such an amount of labour supply. The pre-crisis unemployment rate had been around 10 per cent, but in 2013 it soared to 27.5 per cent. The employment rate had been 64 per cent and plummeted to 52.9 per cent. The youth unemployment rate was a shockingly high 58.3 per cent in 2013. It seems that any improvement of the situation will be very slow.

Crisis management weakened the positions of employees. The National General Collective Employment Agreement remained, but the scope of collective bargaining has been limited. The Minister of Labour was entitled to extend the validity of sectoral-level collective agreements to all actors in the sector. This possibility was suspended for the time of fiscal adjustment. The scope of decentralised company-level agreements has been extended. Trade union density was approximately 28 per cent before the crisis: 18 per cent in the private sector and 60 per cent in the public sector. Recent data are not available. The Greek people objected the austerity measures and organised national and company-level strikes. In 2011, there were 455 such cases in the private and public sectors (Eurofound 2014; Karamessini 2012).

The Greek social welfare system is not really effective, as demonstrated by the fact that there is almost no difference between the proportion of those who are at risk of poverty before and after the social transfers. The non-coverage rate of the jobless poor is the highest in Greece at 68.2 per

cent within the EU (EC SWD 2014r: 12). As described above, social benefits and wages decreased as the result of crisis management, so it is hardly surprising that social inequalities and the rate of those at risk of poverty have increased significantly (Table A.8). The rate of the severely materially deprived almost doubled by 2013, when it reached 20.3 per cent. The pension reform in 2010 reduced the scope of the state guarantee to the basic pension and brought the pension system of civil servants in line with the private sector pension system by eliminating its more favourable provisions (Karamessini 2012).

The reform of the education system has been part of the obligations imposed by the rescue package; indeed, Greek education is in great need of reforms, especially because its PISA results are below average. Furthermore, Greece needs to upgrade vocational education and training, thereby increasing the level of skills relevant in the labour market. Currently, the organisational rationalisation of primary and secondary education has been accomplished, and the increase in the number of students per classroom and in teaching hours has brought Greece closer to the OECD average. In higher education, there have been organisational mergers to eliminate duplications, and an external Quality Assurance Authority has been established, which is an opportunity to improve quality (EC SWD 2014r). The Greek society carried a huge burden in the last half-decade. According to the calculations performed by Antzoulatos (2011), a wage decrease of at least 30 per cent is necessary to achieve the REER present at the end of the 1990s and to restore Greece's competitiveness. However, it was obvious as early as 2011 that this decrease would not be enough in itself. Total investment plummeted by 16.8 per cent in 2011 and 28.7 per cent in 2012, and it was expected to be positive only in 2014 (European Commission 2015: 154). Labour productivity per working hour dipped below 75 per cent of the EU-27 average. The stock of FDI peaked at only 16 per cent of GDP, but in 2012 it shrank to 9.7 per cent. It currently seems that the series of new austerity measures will never end, and the official estimates related to the rescue packages always tend to overestimate the GDP and the expected privatisation revenue. In 2013, the European Commission and the IMF forecast that the debt-to-GDP ratio would be reduced to 124 per cent in 2020. Experts in the OECD estimated 157 per cent, and in view of preliminary events, this

latter figure seems to be more realistic (OECD 2013e: 23). In January 2015, the parliamentary elections in Greece were won by the radical left-wing political party, Syriza, which was against the austerity measures. Later, the party formed a coalition government with the Independent Greeks, a national right-wing party. After very conflict-ridden negotiations in the summer of 2015—despite the earlier promises and the result of a referendum that refused the conditions of the new rescue package—the Greek government accepted the strict conditions of a third adjustment programme with further austerity measures in the framework of the European Stability Mechanism.

7.2 The Two New Mediterranean Member States: Cyprus and Malta

The two small Mediterranean countries and new EU member states, Cyprus (with a population of 1.2 million) and Malta (with a population of 420 thousand) were not involved in the cluster analysis due to a lack of data. The crisis has shown that if a country has a large banking sector compared to its economy, in spite of its small territory, the adequate or—on the contrary—poorly regulated mechanism of the financial system may have an impact on the entire EU. Therefore, it is worth taking a look at the performance of Cyprus and Malta during the crisis (Table 7.2).

After 300 years of Ottoman Rule, Cyprus was part of the British Empire between 1878 and 1960. After Cyprus gained independence, in 1974, a group of Cypriot military officers supported by the Greek junta sought a union with Greece and staged a coup against Archbishop Makarios III, first President of Cyprus. In response to the coup, to "protect" Turkish Cypriots, Turkey invaded the northern part of the island, which was proclaimed the Turkish Republic of Northern Cyprus in 1983; it remains a *de facto* state—it is recognised only by Turkey. In relation to the EU accession, the plan to reunite the island was raised, but the Greek Cypriots rejected it in the referendum against the Turkish Cypriots who were in favour of reunification. Therefore, in 2004, the Republic of Cyprus joined the EU as a *de facto* divided island, and the membership of the invaded Northern areas was suspended. Cyprus adopted the euro

Table 7.2 Some of the major macroeconomic indicators of Cyprus and Malta 2004–2013

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment—volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T−1	Nominal unit labour cost index (2010 = 100)—percentage change T/T−1
Cyprus								
2004–2008 average	4.2	4.6	9.0	62.5	266.8	−8.6	0.5	1.5
2009	−2.0	5.4	−9.7	53.5	303.3	−10.7	1.0	4.3
2010	1.4	6.3	−5.1	56.5	315.3	−9.8	−4.1	1.0
2011	0.3	7.9	−9.4	66.0	330.7	−3.4	0.1	2.7
2012	−2.4	11.9	−20.7	79.5	331.4	−6.9	−2.0	−2.6
2013	−5.4	15.9	−17.1	102.2	344.8	−1.9	1.1	−5.9
Malta								
2004–2008 average	2.8	6.8	0.7	64.4	139.7	−6.5	1.5	1.9
2009	−2.5	6.9	−14.2	67.8	164.8	−8.9	0.7	5.6
2010	3.5	6.9	26.4	67.6	160.4	−6.0	−5.0	0.2
2011	2.2	6.4	−18.0	69.8	156.8	−0.8	−0.8	4.3
2012	2.5	6.3	−0.5	67.9	144.9	2.1	−2.0	4.1
2013	2.5	6.4	2.3	69.8	136.5	1.4	1.4	1.2

Source: European Commission (2013a), Eurostat

in 2008. The question of reunification has come up from time to time in the process of negotiations between the parties but without results so far.

The Knights of Malta protected the small island from the invasion of the Ottoman Empire. In 1814, *Malta* became a British Dominion and was granted independence in 1964. Both islands are part of the Mediterranean, and both were under British rule and British administration for a long time. This historical legacy played a role such that, in both countries, the globalisation processes of the 1990s were adopted and utilised and EU membership was granted, thereby making these countries financial services centres. Tax rules attracting foreign capital, accountancy rules and banking provisions according to the British standards, professionals with knowledge in the fields of legal and accounting matters and mastery of the English language are all features that have their roots in the colonial period. According to the ECB database, in 2008, total bank assets were approximately seven times the GDP in both countries.

Pegasiou (2013) introduces the institutional system of *Cyprus* within the framework of the VoC literature. Thus, Cyprus is categorised under the Mediterranean model of capitalism with unique features deriving from the country's historical background. The government played a very important role in the economy as both owner and regulator. The number of employees in the public sector doubled between 1980 and 2010. The country's performance in terms of public administration, which was a British legacy, has gradually deteriorated and lost its efficiency. The electricity supply, harbours, and the leading telecommunications service provider are entirely owned by the state; in addition, the state has a majority shareholder status in the national flag carrier. Political patronage and clientelistic practices—similar to other Mediterranean countries—are both inherent features of extensive state influence. Labour relations, on the other hand, have been peaceful and cooperative—the traumatic events of 1974 strengthened solidarity among the Cypriots. Nevertheless, the influence of trade unions has decreased here as well; the negotiations between employees and employers are often performed at the individual and company levels. The split between outsiders and insiders in the labour market appeared in Cyprus as well, especially after the EU accession, when the number of immigrants began to increase. The features of the Mediterranean model—a fragmented and politicised system

and the importance of the family and the church—can also be found in the Cypriot welfare system. At the same time, the level of expenditure on social protection benefits is lower than in the large Mediterranean countries (approximately 20 per cent) (EC SWD 2014m: 21), but the indicators for inequality are more favourable (Table A.8). In education, the PISA results of the Cypriot students are below average (OECD 2013j: 5). The tertiary attainment rate is high—which is not characteristic of the Mediterranean countries—and traditionally, many obtain their diploma abroad. The labour market demand for employees with higher education degrees was triggered by the development of the banking sector. The financial system is bank-based; in this respect, Cyprus is similar to the other Mediterranean countries. More than two-thirds of the banking system was in Cypriot ownership when the crisis began, and three of these banks dominated the market. The banks were operating within an oligopolistic and loosely regulated environment; the banking system was politically influenced, where writing-off debts and granting favourable loans depended on political considerations. Intertwining the Cypriot and Greek economies was characteristic of the banking sector, and it had serious consequences during the crisis. Not only Greek companies and households but also the Greek state—through its bonds—was among the clients of the Cypriot banks. After the Greek debt haircut in 2012, up to 75 per cent of the value of the bonds was lost; for Cyprus, this equated to nearly 25 per cent of the country's GDP (EC SWD 2014m: 19; Pegasiou 2013: 344).

The crisis in 2008 put an end to a period of impressive progress that lasted for more than a decade in Cyprus. Although the current account deficit had increased before the crisis, competitiveness declined, which was indicated by the appreciation of REER. Automatic wage indexation deteriorated cost competitiveness. The increase in real estate prices and the stock of mortgages also took place in Cyprus; the former was driven primarily by external demand for housing. Nevertheless, events took a dramatic turn when financing problems of the banking system and public finances arose. Greek and Cypriot government bonds were downgraded by the credit rating agencies, which adversely affected the banks that owned such bonds. Confidence was shaken in terms of the financial sustainability of Cyprus due to the difficulties of public finances and

because Cyprus was severely affected by financial contagion from Greece. An additional concern was the relatively large size of the banking system. Cypriot government bonds could be sold only with outstandingly high yields in 2011. Cyprus needed international support. Regarding the strongly affected Russian clients of the banking system, in December 2011, Russia signed a bilateral loan agreement with the Cypriot government, providing a loan of EUR 2.5 billion. This amount was not enough to cover the country's financing needs in 2013 or the recapitalisation of the banks. In 2013, Cyprus concluded an agreement with the "troika" for a three-year loan of EUR ten billion (ECFIN DG 2012b: 28; European Commission 2013e: 7).

Since then, the Cypriot government has begun the adjustment programme with the usual austerity measures in the social welfare system with pension reform (European Commission 2013e), but the end of the economic recession was expected in 2015. In 2013, the downturn was 5.4 per cent. Unemployment increased—in line with this decline—for at least two years, reaching 16 per cent in 2014. The current account deficit is decreasing. The banking system is on the path of slow stabilisation; in 2013, the total assets of the banking sector amounted to only five times the GDP. The costs of recapitalisation and asset relief interventions accounted for 10.1 per cent of 2012 GDP. Restructuring resulted in the 99 per cent state ownership of the Cooperative Central Bank in 2014. Regulation and financial supervision have been tightened, and an anti-money-laundering action plan has been implemented (EC SWD 2014m: 8–9; 19 European Commission 2014g). Consolidated debt in the private sector was 3.4 times the GDP in 2013, and growth has not taken a turn yet. A detailed plan was prepared about the privatisation of the state-owned companies, and a privatisation law was enacted at the beginning of 2014, creating the necessary institutional framework. In the field of certain specific services (construction and travel), amendments to the legislation were adopted to enhance competition. The wage indexation mechanism was reformed on the basis of a tripartite agreement in order to make the labour market more flexible. In 2012, even this was suspended (EC SWD 2014m).

In the case of *Malta*, no VoC analysis of its institutional system—similar to that of Cyprus—has been available. Taking the indicators of

the WEF into account, it can be seen that the institutional and regulatory features of the Maltese economy are generally in line with the Mediterranean countries. The values of the indicators are very close to the averages of Cyprus, Greece, Italy, Portugal, and Spain (ECFIN DG 2014l: 31). Nevertheless, the structure of the Maltese financial system and its regulatory environment caused the Maltese economy to take another path. The banking sector consists of three components. First, there are five domestic core banks servicing the domestic economy, with total assets amounting to 2.2 times the GDP. Second, the activities of the other, non-core domestic banks, representing 0.8 times the GDP, are focused largely abroad. Third, although total assets of the foreign banks amount to five times the GDP, these banks—among which the Turkish and German groups of banks play an outstanding role—do not relate to the Maltese economy. The activities of the insurance and investment funds are significant as well. The crisis could not shake the banking system: due to the conservative business model of the core banks, the high savings rate of households, and the marginal role of wholesale funding, banks were not in need of government subsidies or any refinancing of the ECB. International banks were recapitalised by their parent banks to such an extent that their tier 1 capital adequacy ratio was 131.5 in June 2013. Malta did not have to spend to restructure banks (ECFIN DG 2014l: 21; European Commission 2014g). The size of the banking sector even increased during the crisis, and in 2013, its size was the same as it had been at the beginning of the crisis—seven times the GDP (EC SWD 2014w: 36). Favourable taxation (a simplified system of paying taxes), the stability of the regulatory environment and banking supervision—equally covering domestic and foreign banks, with the same procedures for both—all contribute to Malta's attractiveness.

Naturally, the crisis also affected the Maltese economy; deleveraging cannot be avoided due to the increased amount of private sector debt, but altogether, it weighs less heavily on the economy than in many other EU member states. Public debt remains approximately 70 per cent in the medium term, and now, it seems that it is manageable with domestic savings. Nevertheless, it poses a risk in the long run because of the ageing of the population. Unlike Cyprus—where services dominate exports and where 27.2 per cent of its export market share was lost between

2008 and 2013—Malta has achieved improvement in services (tourism, remote gaming, and financial services) and in certain segments of the export of goods since the outbreak of the crisis. Therefore, between 2008 and 2013, Malta did not lose export market shares. Goods exports include the traditional semiconductors industry and the emerging transhipment of oil. Malta has benefitted from its favourable geographical position and has become a centre for transhipment and logistics in the area. Although its cost competitiveness has declined since the beginning of the 2000s, wage increases have converged with the modest rate of productivity growth since the beginning of the crisis. The mechanism of automatic wage indexation exists in Malta, but its impact is counterbalanced—at least in the private sector—in such a way that there is a possibility of flexible wage bargaining at the company level. At the same time, the inefficiency of public administration deteriorates the economy's competitiveness (ECFIN DG 2014l). Trade union density is high (approximately 60 per cent), but collective agreements are concluded only at the company level in the private sector. There were some strikes in relation to the market liberalisation, mainly in the public sector, but social partners are committed to cooperation (Eurofound 2014). As far as education is concerned, Malta compares well with the other Mediterranean countries, the rate of enrolment is among the lowest in both vocational and tertiary education (ECFIN DG 2014j: 39, 41). The results of the 2009+ PISA test were rather poor (EC SWD 2014w). The indicators for social inequalities and poverty are below the EU average and the euro area average, but they increased during the crisis. Public expenditure on social protection did not reach 20 per cent of GDP; the high proportion of means-tested benefits indicates the presence of the Anglo-Saxon system, and the large proportion of cash benefits is characteristic of the Mediterranean countries (National Statistics Office Malta 2014: 24–27). For fiscal consolidation, Malta did not curtail the low expenditure on social benefits; moreover, even minimal growth was planned for the coming year. Instead, taxes were increased. Although the level of taxation is not high in Malta, the pension system, which was reformed in 2006, must be addressed in the future. The introduction of the private third pillar does not reduce the burden on public pension spending (EC SWD 2014w).

The economies of Cyprus and Malta indicate that, although they share similar historical backgrounds (a British colonial past), certain elements of the Mediterranean model (bureaucratic public administration, a bank-based financial system, and a weak innovation system), the globalisation and the exploitation of the opportunities offered by the EU (offshore financial services centre of a relatively similar size), only one difference—the different institutional and regulatory solution—was enough in a single sector, the banking sector, and an external shock could direct the two countries onto diverse pathways. At the same time, it is interesting that Cyprus is showing signs of development when the development of the innovation system is taken into consideration, which is traditionally considered in economics the most conclusive factor in terms of long-term growth. Cyprus has been given a favourable assessment by the Innovation Union Scoreboards since 2008, usually ranking first among the Mediterranean countries, overtaking Italy, while Malta has always been a moderate innovator, taking its place among the post-socialist countries. In terms of labour force qualifications, Cyprus again has a more favourable position. Nevertheless, in Cyprus, the crisis of the banking system dragged the whole economy down; thus, its growth potential has declined in the long run. Malta maintained its stable financial system and remained on a path of sustainable growth by exploiting market niches—although at a lower level than before the crisis.

7.3 The Risk of Persistent Divergence

The difficulties suffered by the Mediterranean countries during the crisis caused all of them (with the exception of Malta) to lose their positions in the per capita GDP ranking relative to the EU-28 average, and even Italy has sunk below the average (Fig. 7.1). One way of measuring the success of their crisis management is to determine whether these countries are able to reverse this process and whether they are able to avoid persistent divergence.

Before the global economic changes and the neoliberal shift of the 1980s, the Mediterranean model was similar to the continental one: the product market was relatively regulated, the financial system was bank

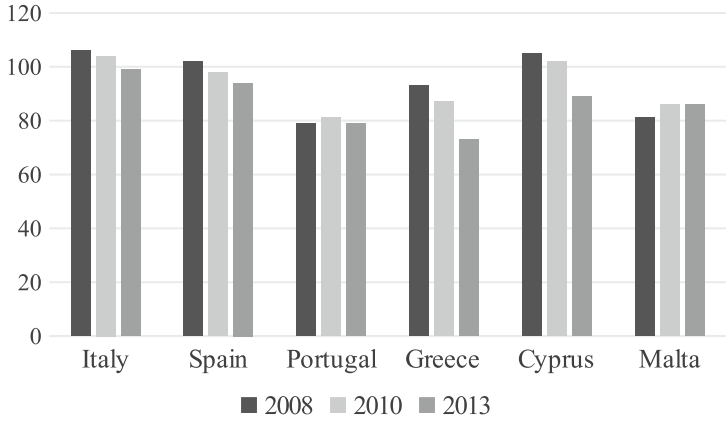

Fig. 7.1 GDP per capita at PPP in Mediterranean countries (% of the EU-28 average), EU-28 = 100. *Source*: Eurostat

based, the EPL was considerably strong, the wage agreements between employers and employees were institutionalised and more or less centralised, social protection aimed at status preservation and was covered by social insurance contribution, and, more or less, extended public education was provided. These results are not surprising if we take into account the geographical proximity, the similar historical roots, and the "catching up", "following" type of their modernisation. At the same time, in addition to these similarities, in the different institutional areas, certain specific features developed that made it possible to describe a characteristically Mediterranean model. These features, however, were mainly unfavourable in terms of efficiency and economic competitiveness. State intervention in the product market was larger, the size of the public sector was larger, the burden of regulation was more significant, the operation of the labour market was less flexible, the welfare state could not lessen the inequalities in income relative to social expenditure, the willingness to cooperate was weaker in the relationship between employers and employees, and the educational system was less successful than those in the continental countries. The reforms of the 1990s—as introduced in Part II—began to head towards market liberalisation similar to the continental countries, but instead of layering, bricolage (see 1.6 of Part I) expresses rather well what occurred. No efficient hybrid solutions were

created such as those in some of the continental countries. The reasons for this are to be found in the worse performance of the state and the public administration, in the lack of or the low level of cooperation between social groups, especially between employers and employees and between the political parties representing them, and in the lack of social support of economic reforms, which was a consequence of the latter.[3]

The Mediterranean countries did not embark on a different development path during the crisis than in the preceding two decades. Those changes and reforms that were implemented as part of their crisis management were realised under the supervision of the EU and the IMF as criteria of a rescue package in four of six countries. Therefore, it is not surprising that the reforms again pointed to the direction of liberalisation. Nevertheless, neither Italy nor Malta showed different economic policy objectives, either. Obviously, half a decade is a very short time for profound changes; it takes time for reform measures to unfold, and in the middle of the recession, they cannot achieve their goal (for example, measures aiming at decreasing the duality of the labour market). The individual analyses of countries and Table 7.3 (which summarises and compares the changes) clearly indicate that—as expected—there was no breakthrough in the institutional system during the crisis.

The problem is that the Mediterranean countries became trapped in a situation that is extremely difficult to solve. The programs negotiated with the international organisations focused on the stabilisation of the budget and the guarantee of safe repayment of loans. In comparison, supporting economic growth had only a subordinate role.[4] The members of the society could not identify themselves with the reforms—which became obvious after the numerous demonstrations held in the countries that received the rescue packages—and the Italian technocratic government of Monti (2011–2012) was given the cold shoulder, reflecting the same attitude. As time passes, the situation is becoming even worse because the austerity measures were forcibly taken by the government, but the results of such measures are either non-existent or hardly perceivable by the citizens. By 2013, the public debt of all countries, with the exception of Malta, exceeded 90 per cent, and overcoming this debt and the debt of the private sector will reduce economic growth for a long time, inducing further austerity measures.

Table 7.3 Changes in the institutional systems of the Mediterranean countries after 2008

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Before 2008						
Less liberalised compared to the EU, moderate competition in the non-tradable sectors	Innovation system is weaker than the EU average	Bank-based financial system	Dual labour market	Medium-level trade union density, conflict-ridden cooperation between social partners	Medium-level social expenditure slightly reduces inequalities, great emphasis on status-protecting pensions	Proportion of people with low levels of education is high, below-average PISA results
Characteristic institutional and regulatory features after 2008						
Italy						
Small extent of integration into the global value chain, outstanding size of the SME sector	Moderate innovator, with large regional differences	Conservative business model, different mechanisms and performance of core banks and non-core banks	Further liberalisation to reduce labour market duality	Decentralisation in wage agreements, conflict-ridden cooperation between social partners	Austerity measures in social welfare provision, pension reform	Below-average PISA results with large regional differences, shift towards dual vocational training

Spain						
Increasing integration into the global value chain, outstanding size of the SME sector	Moderate innovator, with large regional differences	Conservative business model, different mechanisms and performance of the core banks and the savings banks, housing bubble, restructuring with EU help	Further liberalisation to reduce labour market duality	Decentralisation in wage agreements, conflict-ridden cooperation between social partners	Austerity measures in social welfare provision, pension reform	Below-average PISA results, shift towards dual vocational education and training
Portugal						
Shift towards more favourable product and geographical diversification of exports, outstanding size of the SME sector	Moderate innovator	Indebtedness of the private sector, Portuguese government bonds weighing heavily on the banking system, restructuring with the help of the EU-IMF	Further liberalisation to decrease labour market duality	Decentralisation in the wage agreements, conflict-ridden cooperation between social partners	Austerity measures in social welfare provision, pension reform	Below-average PISA results, shift towards dual vocational education and training, increasing tertiary attainment

(*continued*)

Table 7.3 (continued)

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Greece						
Constrained, reluctant privatisation, outstanding size of the SME sector, tradable sectors play second fiddle	Moderate innovator	Greek government bonds weighing heavily on the banking system, restructuring with the help of the EU-IMF	Further liberalisation to reduce labour market duality	Decentralisation in wage agreements, conflict-ridden relationship, weak cooperation between social partners	Austerity measures in social welfare, pension reform	Below-average PISA results, structural reorganisation to reduce costs
Cyprus						
Incipient privatisation, further liberalisation of services	Innovation follower	Loose regulation, Greek exposure, restructuring of the banking system with the help of the EU-IMF	Transforming wage indexation for a more flexible labour market	Decentralisation in wage agreements, strong cooperation between social partners	Austerity measures in social welfare, pension reform	Below-average PISA results, high enrolment in higher education

Malta						
Shift towards the more favourable products and geographical diversification of exports	Moderate innovator	Conservative business model in domestic banks, strict regulation	Relatively rigid labour market, partial automatic wage indexation	Decentralised wage agreements, strong cooperation between social partners	Extended use of means-tested principle, low level of social expenditure minimally increased	Below-average PISA results, low enrolment in vocational education and higher education

Source: Author's compilation

Strengthening and reinforcing the sources of growth, including but not limited to the innovation system and human capital, require investment. Public spending on education was above the EU average only in Malta, Cyprus, and Portugal before the crisis; the other three Mediterranean countries were well below average, which did not change during the crisis (EACEA 2013: 7). Therefore, it emerges from time to time that, in order to be able to spur economic growth, sources should be created at the EU level (by issuing bonds, restructuring the EU budget, and so on). At the same time, it is extremely difficult to elaborate guarantees and making sure that what happened during the decade before the crisis, when the abundantly available capital flowed into the non-tradable sectors and the development of competitive structures did not take place, will not occur again. For decades, the European Commission has been trying to force the efficient utilisation of the assistance provided under EU cohesion policy by applying increasingly cunning and strict measures, but the results have been ambivalent so far.

The analyses of the individual countries have indicated clearly that the sectoral composition and the corporate structure of the economies should change. Greater emphasis must be placed on tradable sectors, specifically industry; the increase in productivity would revert, presumably, if corporate size were larger. Therefore, these sectors' integration into the global value chain should be deeper. At present, in Greece, Portugal and Spain—the latter with the exception of its automotive industry—specialised export orientation is not visible, according to data on revealed comparative advantage (Jens 2012). Moreover, the administrative constraints and the tax rules all compel companies to remain small in size (Gill and Raiser 2012).

Capital allocation between tradable and non-tradable sectors in favour of the latter is usually explained by the fact that they operate as protected sectors and, due to weak competition, companies receive rent. Does this mean that strengthening the competition *per se* would solve the problem? Dellepiane et al. (2013) make reference to Eichengreen and bring us face to face with the experience that it is easier to assign the new factors of production—regardless of whether they are human or financial factors—to the expansion of production than to the boost in productivity, which implies that the problem is far more complicated. The Spanish example

has shown that behind the occurrence of the hosing bubble, in addition to high profit, there were, in fact, several other socioeconomic factors and institutional conditions. The problems of the Italian and Spanish banking systems have made it clear that the difference between an economy embedded in international relations and the domestic economy can be found not only in the intensity of competition—such as in Denmark or Finland—but also in the institutional environment of their operation. In the Mediterranean countries, direct political influence, building the regime's own clientele and not professional management subsist more easily in the non-tradable sectors.

The complexity of this problem is expressively illustrated by Calvo (2014), who explains that institutional factors were the reasons why banking and telecommunication services came to the fore within tradable sectors in Spain and why industry has lost ground. The government did not have a planning-organising capacity or financial means by which development controlled from above would have been implemented in order to hold out in competition within European integration. Until the reform of the single market at the beginning of 1990s, banks and companies were fairly protected, but due to Franco's deliberately divisive politics, the structure of the elite was fragmented, and there were not strong social, professional intermediary organisations, either. Therefore, a neo-corporatist cooperation, such as that in Germany, could not evolve. Companies operating in the knowledge-intensive and capital-intensive industries had rather limited financial and organisational capacity for product development. Given these specific features, the banking and the telecommunication sectors were the sectors in which such concentration could come about that made the cooperation between the state and a few large corporations possible, without intermediary agents and where both parties are mutually dependent on each other. This non-hierarchical cooperation is named "peer coordination" by Calvo (2014). As the cooperation between the complex service sectors and the state gained strength, resources were drawn away from the knowledge-intensive and capital-intensive industries.

Rangone and Solari (2012) demonstrate why, through the series of Italian reforms, the liberal reforms based on "family capitalism"—due partly to disguised interests and the lack of cooperation between the social

actors and partly to unexpected or disregarded consequences—could not improve economic performance.

More than a half decade has passed since the crisis began, and the following question remains unanswered: which Mediterranean country will be able to reverse the process of moving away from the economic average of the EU over the long-term? The obstacles that impeded the creation of more efficient hybrid solutions before the crisis and those referred to above (weaker performance of the state and public administration, the lack of social support in backing reforms, and the low level of cooperative attitude between the social and economic actors) have not disappeared. These countries currently face the task of finding efficient institutional solutions that match their own circumstances and facilities. In the last part, we return to those consequences that arise from this insight and that have relevance for European integration and economic governance.

Notes

1. The ECB and the national central banks together constitute the Eurosystem, the central banking system of the euro area.
2. Banyuls and Recio (2012) do not give an estimation of the size of the shadow economy; nevertheless, a significant size of the shadow economy may be assumed if we take account of the fact that the contradiction between the lax immigration policy and the strict labour laws has been bridged by immigrants' illegal employment.
3. The size of shadow economy indicates how poorly managed the relationship between the state and its citizens is. As far as shadow economy is concerned, not only Greece has a higher value (24 per cent) than the continental countries, but the estimates for Italy, Spain, and Portugal (21 per cent, 19 per cent and 19 per cent of GDP, respectively) also exceed the value characteristic of the continental countries (10–15 per cent) (Schneider and Kearney 2013: 4).
4. A detailed critical review of the programs related to the rescue packages is provided by Aiginger (2013).

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8

Crisis Management in the Central and Eastern European Member States

8.1 The Fall and Quick Rise of the Baltic States

The situation of the Baltic countries during the crisis is unique in two respects: first, these countries suffered the deepest decline in 2009, and second, these countries accomplished the most rapid and most radical adjustment (Table 8.1). All Baltic countries had an overheated economy before the crisis began. Their spectacular economic growth was built primarily on internal demand, and imbalance manifested in the current account deficit, while fiscal policy was stable, though pro-cyclical. When the crisis began, capital inflow stopped, the real economy began to shrink rapidly, and tax revenues decreased. Such circumstances shook even those budgets that were otherwise stable. Austerity measures were needed.

Estonia, with a pre-crisis growth rate of 5 to 6 per cent, was at 70 per cent of the EU-27 average in terms of GDP per capita at PPP in 2007 (while the corresponding rate was only 36 per cent in 1995), and only Slovenia and the Czech Republic overtook Estonia among the EU-10 (Table 4.2). Investments were financed by FDI, domestic currency pegged to the euro, and loans enjoyed the low interest rates characteristic

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Table 8.1 Some of the major macroeconomic indicators of the Baltic countries 2004–2013

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment-volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T–1	Nominal unit labour cost index (2010 = 100)—percentage change T/T–1
Estonia								
2004–2008 average	5.6	6.7	7.3	4.4	:	–12.3	2.9	10.0
2009	–14.7	13.5	–39.0	7.2	153.3	2.7	2.0	2.4
2010	2.5	16.7	–2.6	6.5	140.5	2.8	–3.7	–4.9
2011	8.3	12.3	33.0	6.0	124.9	1.8	1.0	–0.8
2012	4.7	10.0	10.4	9.7	125.8	–1.8	–0.8	3.4
2013	1.6	8.6	2.5	10.1	119.4	–1.0	2.9	6.8
Latvia								
2004–2008 average	7.3	8.5	10.6	13.4	89.9	–16.7	3.7	16.9
2009	–14.2	17.5	–37.4	36.4	125.0	8.6	5.0	–11.6
2010	–2.9	19.5	–20.0	46.8	132.4	2.9	–7.9	–9.1
2011	5.0	16.2	24.2	42.7	115.4	–2.1	0.7	0.2
2012	4.8	15.0	14.5	40.9	97.2	–2.5	–1.5	2.7
2013	4.2	11.9	–5.2	38.2	90.9	–0.8	–0.9	7.3
Lithuania								
2004–2008 average	7.1	6.7	12.1	17.6	201.2	–10.6	1.3	7.3
2009	–14.8	13.8	–39.5	29.0	287.8	3.7	6.8	–1.7
2010	1.6	17.8	1.4	36.3	257.6	0.1	–5.3	–6.9

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment-volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T–1	Nominal unit labour cost index (2010 = 100)—percentage change T/T–1
2011	6.1	15.4	19.4	37.3	223.9	–3.7	0.5	0.7
2012	3.8	13.4	–1.6	39.9	211.2	–0.2	–2.0	2.2
2013	3.3	11.8	7.0	39.0	194.7	1.5	0.9	3.0

Source: European Commission (2013a), Eurostat

of the euro area. Nevertheless, the composition of the FDI changed over the course of nearly a decade. While in 2000, the share of manufacturing was 21.6 per cent, financial intermediation was 24.3 per cent, and real estate development was 7.8 per cent, in 2007, the share of manufacturing decreased to 14.6 per cent, financial intermediation increased to 33.2 per cent, and real estate development soared to 26.8 per cent (OECD 2009b: 26). The increase in the share of non-tradable sectors caused the elevation of the current account deficit, which was already 15.9 per cent in 2007. The Estonian government withdrew its promises concerning the increase in wages and welfare provision; thus, the deepest point for the government deficit was in 2008, at 3 per cent, which was reduced to 2 per cent in 2009. Because automatic stabilisers were functioning (for example, unemployment benefits), the government took a deficit-reducing measure accounting for 7 per cent of GDP in 2009. In 2009, wages in the public sector were reduced nominally and gradually in several steps, by 4.3 per cent on an annual basis. Here, it must be noted that in each year between 2004 and 2009, nominal wages increased by 10–20 per cent. In addition to reducing pension benefits and sickness benefits, the regulation of the various welfare provisions changed as well, and in 2010, the retirement age was raised (Purfield and Rosenberg 2010: 19, 25). Otherwise, moderate fine-tuning was accomplished in the social protection system in relation to family benefits. Expenditures on social protection benefits remained as low as they had been before the crisis; as the GDP (the reference value) has been increasing, it is heading towards 12 per cent again (EC SWD 2014n: 16–17, 42).

For Estonia, currency devaluation could not be an option—not with the remaining currency board—only internal depreciation. Provided that the country had given up its exchange rate regime, the adoption of the euro would have been delayed, and its economic gain would not have been substantial, either. First, confidence in the Estonian economy would have been shaken, and as a consequence, the country's macroeconomic stability would have been affected. Approximately 90 per cent of corporate and private loans were denominated in euros (Levasseur 2012: 125); therefore, the proportion of NPL would have leaped as a result of currency devaluation. Its potential to increase competitiveness would have been limited, as the import content of exports is high. The govern-

ments of all three Baltic countries assessed the situation similarly, and in all three, the government decided to maintain the current exchange rate regime. However, by doing so, the Baltic countries had to bear shocks; the societies of the other crisis-hit EU countries could not bear them and were not willing to bear them.

The current account deficit soon disappeared, and the country ran a surplus of 2.7 per cent in 2009. In 2012, there was again a current account deficit of approximately 1 to 2 per cent. The disappearance of the current account deficit took place after the inflow of FDI through the banks had stopped; lending activity declined, resulting in a contraction of the real economy and corporate investments and an increase in household savings. The above process was the same in all three Baltic states.

The Estonian banking system is almost entirely in the ownership of the Northern bank groups; when the crisis began, the four major banks (Swedbank, SEB, Sampo, and Nordea) had a market share of 95 per cent (OECD 2009b: 79). The banking system remained stable, thanks to the parent banks, as the Estonian subsidiary banks were supported directly by the parent banks in order to maintain liquidity. The real estate bubble burst: Eurostat considers the real estate price index in 2010 to be the reference value (100), and relative to this reference value, the annual index in 2007 was 186.5, while the index in 2009 was 98. Nevertheless, the share of NPL did not reach 6 per cent in any of the years mentioned (EC SWD 2014n: 39). The Bank of Estonia and the Financial Supervisory Authority had several macroprudential regulations to make the lending standards and the related risk management more strict—which also contributed to maintaining the stability of the banking system. They could not manage limiting credit growth, but they were highly successful in maintaining a liquid and well-capitalised system (Sutt et al. 2011).

Before the crisis, wages increased by 16 per cent annually between 2004 and 2008, leading to the steep elevation of ULC and the appreciation of REER. In 2009, there was a nominal wage adjustment, in which the private sector took the lead. Together, the private and the public sectors performed a decrease of about 4 per cent each (Purfield and Rosenberg 2010: 22, 25). The decrease in wages immediately improved cost competitiveness and helped spur the growth of exports. Price and Wörgötter (2011) demonstrate with the help of pre-crisis data that Estonian inward

FDI was driven mainly by the aim to exploit cost advantages and obtain market shares, and value added of Estonian exports remained low. The neighbouring Nordic, Baltic states and the CIS remained Estonia's main trading partners; Estonia was less successful in increasing its market share within the EU than the Visegrád countries. The Estonian companies are predominantly small and the contribution of large corporations to value added is well below the EU average. The Estonian SME sector is very active in the international relations, but their revealed comparative advantage was primarily the export of low-tech and medium-low-tech products in 2009 (OECD 2012a). The share of FDI in per cent of GDP did not decrease during the crisis, either; moreover, it steadily increased to over 80 per cent, and per capita FDI rose uninterruptedly (except for the year of 2009). There were some changes in its structure, though, the share of the financial and insurance sector decreased significantly (to 24.4 per cent in 2012), the share of the manufacturing sector exceeded 16 per cent. Within the manufacturing industry, the share of the sectors with lower technological levels decreased (Hunya 2013: 41, 63). Its impact can be seen in the export of high-tech products as a percentage of total exports: since the pre-crisis level of around 7 per cent, it has risen to 14–15 per cent. The Estonian economy was able to increase its global market share during the crisis by 14 per cent (2013) compared to 2008. Estonia maintained its place among the innovation followers, but cooperation is weak between the public and the private sectors (EC SWD 2014n).

Estonian companies tried to keep their workforce via wage decreases and working hour reductions. The unemployment rate increased from the pre-crisis level of below 5.5 per cent to 16.7 per cent in 2010; then, it decreased again to 8.6 per cent in 2013. In 2009, the reaction of the government to the rapid increase in unemployment was the further liberalisation of the labour market (relaxing the conditions for dismissals and tightening the entitlement rules on unemployment benefit). Estonian society accepted these austerity measures (similar to the others), and because trade unions were weak (trade union density is quite low compared to other parts of Europe), there were no demonstrations or strikes. One part of the unemployed, especially the unskilled men who had been dismissed from the construction industry, went abroad to work, primarily to Finland. Depopulation has been 7 per cent in the last one and a

half decades, partly due to the low number of births and partly due to emigration. Kaska (2013: 31) makes reference to the 2011 census, which reveals that 2.4 per cent of the total population has left Estonia and moved abroad since 2000. This value is not high at all, especially given that we know that during the crisis, the number of those who returned to Estonia increased. At the same time, one must admit that the data seem a bit uncertain because in the same volume, Hazans (2013: 69) calculates a 5.9 per cent net migration rate in the case of Estonia between 2000 and 2010. The analysis of the European Commission (EC SWD 2014n) expressly lists emigration among the reasons for the shrinking labour force.

According to the 2012 PISA report, Estonia's performance is the second best among the EU member states, after the Netherlands (OECD 2013j: 5). The government considers and handles education as a sector of strategic importance, regardless of the crisis and according to the OECD (2014b: 258), public expenditure on education (as percentage of GDP) exceeds 5 per cent, and, according to the EACEA (2013:7), 6 per cent. Nevertheless, a significant skills mismatch has evolved between the qualifications and the working places because a great proportion of jobs that terminated in the non-tradable sectors—especially in the construction industry—do not regenerate. There is a risk that the lack of skilled labour force will hinder economic growth and may generate a wage rise that again exceeds productivity growth. The government launched ambitious reforms to tackle the problems in the fields of tertiary education-with the aim of attracting more students to science, technology, engineering and mathematics-, as well as vocational education and training (EC SWD 2014n).

Social inequalities—which were considerable to start with—have grown since the crisis, no matter the means of measurement: the Gini indicator or the income quintile share ratio (Table A.8). The ratio of the severely materially deprived was 7.6 per cent, which is below the 2013 EU average (9.6 per cent), but it has risen compared to the 4.9 per cent in 2008.

The driving factors of the crisis in Latvia and Lithuania were very similar to the ones in Estonia. Therefore, I wish to underline those phenomena and processes that were different. When the effects of the Russian crisis in 1998–1999 wore off, the 2000s saw an economic boom, at the end of which *Latvia* entered the crisis with an even more overheated

economy than Estonia, as indicated by the outstandingly large deficit of the current account (22.4 per cent) in 2007. The wages increased more rapidly than in Estonia, after 2005, by 20–30 per cent in nominal terms. The housing bubble swelled even more, and the price index in 2007 was 187.3 (compared to 2010 = 100). Deficit was kept under control by the government in Latvia (during pre-crisis years, under 1 per cent), but fiscal policy was pro-cyclical here as well. The dramatic extent of the impact of the crisis is demonstrated well by the fact that the deficit could have reached 16–18 per cent of GDP in 2009 without the measures taken. The government accomplished an unprecedented level of adjustment amounting to 11 per cent of GDP, in the public sector, nominal wages were reduced by 11 per cent annually, in the last quarter of the year by almost 24 per cent (Purfield and Rosenberg 2010: 18, 25). Even so, the deficit was still 8.9 per cent in 2009, but by 2013, it was only 0.9 per cent. According to expectations, by 2016, Estonia will succeed in elevating growth over 3 per cent.

From the three Baltic countries, Latvia's reaction to cooling down the economy by economic policies or stricter regulation was the slowest. The most severe consequence of this slowness could be felt in the banking sector, where foreign ownership was 70 per cent, and there were some domestic banks. Half of the depositors were not residents of Latvia; they were mainly Russian and other citizens of the CIS. It has been mentioned in Part II that offshore activity played an important role in the Latvian economy. When the crisis hit the country, the confidence of the depositors was shaken, and those who did not reside in Latvia began to withdraw their money from the Latvian banks. Parex Banka—a domestic-owned bank with a 20 per cent market share—was the first bank to fall victim to this process. In order to maintain financial stability, the Latvian government took a 51 per cent stake in the bank (later extended to 85 per cent) in October 2008. Consequently, capital markets lost confidence in the Latvian government itself, and the government sought support from the IMF, the EU and Nordic countries (Purfield and Rosenberg 2010: 7–8). Latvia used EUR 4.5 billion out of the EUR 7.5 billion package between 2009 and 2011. The three-year long programme was closed on 20th January 2012. Within the framework of the programme, the state-owned Mortgage and Land Bank of Latvia (*Latvijas Hipotēku un zemes*

banka) had to be recapitalised. The share of NPL was approximately 16 per cent at most, and in 2012, it sank below 10 per cent. The regulation and supervision of the financial sector have been tightened, especially in the case of banks owned by non-EU entities and with high exposure to non-EU customers. State-owned banks have been restructured, their privatisation is on its way, only one branch of the Mortgage and Land Bank of Latvia has been kept, which will function—according to the plans—as a Single Development Institution. Bank restructuring costs amounted to 4.3 per cent of the 2012 GDP (EC SWD 2013d: 15–16, 36; European Commission 2011a: 11; European Commission 2014g).

Latvia runs current account deficits of approximately 2 per cent, which is a sustainable level. The stock of FDI does not reach the average of the post-socialist EU member states, regardless of whether it is examined per capita or as a percentage of GDP, and its value at 45 per cent of GDP is far behind Estonia's value at 80 per cent of GDP. Within FDI, financial and insurance activities have decreased by 7 percentage points since 2009 (to 27.4 per cent in 2012), but nevertheless, the share of the non-tradable sectors (wholesale and retail, real estate development, and construction) is dominant, while the share of manufacturing is 11–12 per cent. Within the latter, processing primary products (rubber, plastics, other non-metal mineral products) is dominant (Hunya 2013: 40–41, 71). The structure of the economy is in line with the fact that Latvia has the penultimate place in the ranking of the EU 2014 innovation scoreboard. The expenditure of the business sector is outstandingly low, 0.15 per cent of GDP, but public expenditure is also only 0.51 per cent (European Commission 2014c: 82). The Latvian economy was able to increase its global market share, even with low-tech products during the crisis, by 8.4 per cent during five years until 2013.

The radical adjustment had dramatic consequences on the labour market as well; the unemployment rate tripled by 2010 and almost reached 20 per cent. Latvian employers chose dismissals instead of wage reduction, contrary to the other two Baltic countries. As a result, many Latvian people went abroad to find employment. Latvian emigration exceeded the Estonian emigration by a great margin, even before the crisis, and as a consequence, between 2000 and 2011, Latvia lost almost 13 per cent of its population, 63 per cent of which was due to emigration. As a reac-

tion to the crisis, the number of Latvian people working in other EU countries increased to an unprecedented extent, by 47 per cent between 2008 and 2011. The outmigration flow since EU membership, especially during the crisis, has jeopardised the reproduction of the Latvian population. The proportion of migrants with tertiary education was between 24 and 32 per cent in the last decade. Slight deceleration has been observed in outmigration since 2011 (Hazans 2013: 66, 84; OECD 2013h: 270). The flexible labour market was able to adapt quickly to the changes in economic performance, which may slow down outmigration as well. In 2013, the unemployment rate was 11.9 per cent, and a further decrease can be expected.

Latvian trade union density is only slightly higher (12 per cent) than that in Estonia, but its importance is greater. The main level of collective agreements is that of the company, but there are national level agreements. Naturally, the draconian austerity measures were on the agenda of the tripartite negotiations between 2009 and 2011. The number strikes is minimal, there were some demonstrations organised by the trade unions due to the declining wages and social circumstances in 2010–2011 (Eurofound 2014). The commotion ensued was a modest one compared to the deterioration that took place in the social situation.

In Latvia, public expenditures on social protection were very low even before the crisis, accounting for 11–12 per cent of GDP. Due to the pre-crisis boom, the rate of the severely materially deprived sank from 40 per cent to 20 per cent in 2008. In 2011, it again reached 31 per cent because of the wage reduction, soaring unemployment and cost-cutting in social spending, and due to the economic growth, it decreased to 24 per cent in 2013. Unlike Estonia, indicators of social inequality did not rise from the level that was high originally here (Table A.8). In the system of social assistance, the means-tested principle had only a minor role, but transformations during the crisis made a move towards this principle: means-tested benefits increased from 0.2 of GDP in 2008 to 0.7 per cent of GDP in 2011. In the pension system, the pillar of the compulsory private pension fund was introduced, the retirement age was increased to 65 years, and early retirement was limited (EC SWD 2014u: 7–9, 40).

Latvia spends quite a lot on education, public spending on education exceeded the EU average even during the crisis, accounting for 5.7 per

cent of GDP in 2011, although its amount shows a decreasing trend compared to the GDP, as well as relative to government expenditures (EACEA 2013: 6–7). In the 2012 PISA test, Latvian students did not produce as outstandingly good results as Estonian students; Latvian students' performance was average (OECD 2013j: 5). Within the education system, vocational education and training are in great need of development in order to meet labour market needs, which are financed by the Latvian government from EU funds. An ambitious programme was launched to improve quality in higher education in 2012, but this accomplishment came to a halt in 2014 (EC SWD 2014u).

The contraction of the *Lithuanian* economy was somewhere between the Estonian and the Latvian economies. With the –14.8 per cent growth rate in 2009, it is more similar to the Estonian economy. Imbalances in the economy are similar to those seen in the other two Baltic countries; the current account deficit hit its deepest point in 2007 at 14.4 per cent. There was also a real estate bubble, and the real estate index was 165.8 per cent in 2007 (2010 = 100 per cent). The fiscal deficit, which had been kept below the Maastricht ceiling prior to the crisis, would have skyrocketed in 2009 in Lithuania (similar to Latvia) as well. The adjustments accounting for 7 per cent of GDP were sufficient to keep the deficit at a 9.3 per cent level. By 2013, the government could bring deficits well below the Maastricht fiscal limit of 3 per cent of GDP (2.6 per cent). Wage reduction, later wage freeze, and social benefit reduction were among the applied actions, but they were intended to be temporary measures for the period of the crisis only, similar to Latvia (Purfield and Rosenberg 2010: 19–20). Expenditure on social protection as a percentage of GDP is decreasing due to the increasing GDP and moving towards the pre-crisis level of 14 per cent. The share of means-tested benefits within social protection is very small here as well; nevertheless, it increased from the pre-crisis 0.2 per cent of GDP to 1 per cent of GDP in 2011. A partial reform of the pension system was accomplished, the second pillar was restructured in a way that includes a monetary incentive designed to encourage savings for old age. The issue of the rapidly ageing population raises questions regarding the sustainability and adequacy of pensions (EC SWD 2014f: 15, 38).

Foreign banks, more precisely, Scandinavian banks, dominated the financial sector, with a market share of above 80 per cent, although this share decreased somewhat during the crisis. The parent banks provided support to their Lithuanian subsidiary banks, which helped them weather the crisis. Two domestic banks were closed, along with several credit unions. Lending conditions were strict, and financial supervision was tightened. The Lithuanian financial sector remained stable, although the share of NPL was still 13.7 per cent in 2013 (EC SWD 2014f: 11, 35).

In spite of these similarities, there were substantial differences between Lithuania and the other two Baltic countries regarding the starting position of their real economies. The Lithuanian economy was heavily hit by the Russian economic crisis in 1998–1999, and it began a structural transformation resulting in a productivity growth. Lithuania's tradable sector was bigger than that of the other two countries, and the increase in wages remained in line with the increase in productivity. The increase in ULC was rather due to the exchange rate effect; Lithuania first pegged its currency to the USD, which appreciated against the euro. On the other hand, REER deflated by ULC did not appreciate as much as it did in Estonia or in Latvia. During the adjustment to the crisis, in 2009, a wage decline of the same magnitude as in the other two Baltic countries took place in the Lithuanian economy, in which the private sector took the lead (IMF 2010).[1] One part of the reforms during the crisis aimed at improving the management of state-owned enterprises, similar to Latvia (EC SWD 2014f).

The inward FDI stock in the case of Lithuania is behind Estonia and Latvia, and it has been fluctuating approximately 35 per cent of GDP since 2005. The share of manufacturing is modest, though it increased during the crisis; it was 27 per cent in 2012. The share of wholesale and retail trade decreased, and the share of financial intermediation and real estate development remained stable. Within manufacturing, the share of processing agricultural and mineral products is high, and a favourable tendency can be seen in case of products with higher value added, such as pharmaceuticals (Hunya 2013: 41, 75). The Lithuanian economy's global market share increased by 22 per cent by 2013. In 2013, Lithuania qualified as a moderate innovator (although took last place among them),

and in 2014, it overtook Poland. Lithuania's innovation performance has improved significantly since 2010, reaching 52 per cent of the EU average in 2013, but the business sector's expenditures on R&D are still anaemic (0.24 per cent of GDP) (European Commission 2014c: 5, 57, 82).

Due to the crisis, the unemployment rate almost tripled in Lithuania: it was 17.8 per cent in 2010, and in 2013, it reached as high as 11.8 per cent. In 2009, the labour code was strongly liberalised, the restrictions on flexible forms of employment were abolished, and the costs of dismissals decreased. Several measures were introduced only temporarily, and the comprehensive reform was delayed. What makes managing unemployment, especially youth unemployment, even more difficult is that the education system fails to adequately meet labour market needs. Lithuanian students performed under the average in the PISA tests, but tertiary education attainment is above the EU average. Nevertheless, the structure of the education system is not adequate; therefore, the government provides increased funding for maths, science and technology studies, besides other measures targeting quality improvement. Vocational education and training is relatively unpopular, and its quality is poor in Lithuania. The reforms could make only limited progress so far (EC SWD 2014f). In Lithuania, public spending on education decreased at constant prices, but due to the decrease in the GDP, their relative magnitude was 5.8 per cent in 2008 and in 2011, which actually exceeded the EU average (EACEA 2013: 4, 7).

Twenty per cent of the Lithuanian population emigrated from Lithuania between 1990 and 2011 (12.9 per cent out of them after 2000), resulting in the highest net migration rate within the EU in the last decade. The crisis generated a new wave, including especially the young, for which the unemployment rate was above 30 per cent in 2010–2011. If this rate of emigration among the young Lithuanians persists, it will lead to speeding up the natural shrinkage of population as well. The declining economic position of the destination countries was not enough to accelerate return migration; the first increase was registered in 2011. Emigrants who lose their jobs in the destination country very often opt for migrating to a third country. The amount of remittances exceeded 4 per cent of GDP in 2010–2011 (Sipavičienė and Stankūnienė 2013: 46, 51, 60).

It seems that people in Lithuania choose emigration as a way of coping and finding a solution rather than joining any organisations in which interests are represented. Trade union density is around 10 per cent, which is between the Estonian and the Latvian figures. The social importance of the unions is meagre. In 2012 there were some strikes in the sphere of education, not elsewhere. In 2013, the trade unions held a rally in front of the Parliament building, with the aim of raising the minimum wage. Collective agreements are concluded at the company level. In the framework of tripartite concertation, the negotiations have all focused on the liberalisation of the labour code since 2009 (Eurofound 2014).

During the crisis, the greatest worsening could be observed in the EU 2020 poverty indicator—the majority of the pre-crisis results were lost. The worst was 34 per cent in 2010, and then, due to the economic growth, there has been some improvement. The ratio of the severely materially deprived was 12.3 in 2008, and the worsening during the crisis was followed by a recovery in 2013, when it reverted to 16 per cent from nearly 20 per cent. The social inequality indicators did not decline—similar to Latvia—but remained high (Table A.8).

Not even the crisis could deviate the Baltic countries from the path they have been following since they became independent (Table 8.2). These countries are prepared to make all sacrifices to integrate as deeply and irrevocably as possible into the European market economies. They did not give up their free-market economic policy; moreover, their reaction to the sudden increase in unemployment was further liberalisation. They adhered to the exchange rate regime pegged to the euro; following Estonia, Latvia introduced the euro in 2014 and Lithuania in 2015. After the events in Ukraine in 2014, when Crimea was annexed by the Russian Federation, the Baltic countries must have felt vindicated that their efforts were right. At the same time, the fact that the population endured measures aiming at restoring the fiscal and market balance without protest did not mean that individuals had not sought a way out, and their solution was emigration. Currently, it cannot yet be assessed whether their employment abroad will be temporary. It is certain that having low fertility in view, replacement will not happen via the natural growth of the population.

As seen in Part II, Estonia had a pioneering role in the region and applied the provisions of liberal economic policy the most consistently.

Table 8.2 Changes in the institutional systems in the Baltic countries

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Before 2008						
Liberalised, FDI is dominant in the non-tradable sectors	Innovation system is below the EU average	Mainly foreign-owned, bank-based	Liberalised at the level of the EU average, role of active labour market, labour policy is meagre	Role of trade unions is insignificant	Low level of social expenditure, large income inequalities	Its development is important due to nation-building, above-average public spending on education
Characteristic institutional and regulatory features after 2008						
Estonia						
FDI slightly shifted towards manufacturing, high-tech products for export are increasing	Innovation follower, R&D performance is stronger than R&D's impact on the economy	Prudent regulation, stable banking system, real estate bubble	Further liberalisation	No change	Reform for a sustainable pension system	Above-average PISA results, incipient reform to develop vocational training, strengthening tertiary education in technical and science studies

(*continued*)

Table 8.2 (continued)

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Latvia						
FDI is still dominant in the non-tradable sectors, reforms in the management of state-owned enterprises	One of the most moderate innovators	After restructuring of domestic banks, tightening regulations, real estate bubble	No change	No change	Further restriction of social protection intended to be only temporary, reform for a sustainable pension system	Average PISA results, incipient reform to introduce dual vocational system, tertiary education reform stalls
Lithuania						
FDI is more significant in manufacturing, but processing primary products is dominant, reforms in the management of state-owned enterprises	Recent entrance into the category of moderate innovators	After the closure of some domestic banks, tightening regulations, real estate bubble	Further liberalisation came to a halt	No change	Partial pension reform, further restriction of social protection intended to be only temporary	Below-average PISA results, insufficient vocational training, strengthening tertiary education in technical and science studies

Source: Author's compilation

These factors were not changed by the crisis, either; thus, Estonia, suffered least of the three Baltic countries. According to the AMECO database, Estonia reached the volume of the 2008 GDP as soon as 2012, while Latvia and Lithuania could not do the same, not as late as 2013. The ratio for the severely materially deprived is 2–3 times higher in Latvia and Lithuania than in Estonia. Emigration is not insignificant in Estonia, either; but it is not a national issue of crucial importance, as it is in case of Latvia and Lithuania.

An exciting mission would be for comparative research on institutions to find an explanation why Estonia is relatively more successful than the other two Baltic countries—given that after the Soviet era, their position was similar. Norkus (2012), a Lithuanian sociologist, provides a critical overview of the explanations found in the literature, and his answer is quite complex. Estonia's geographical and linguistic proximity to Finland is a significant factor and an advantage, but it was exactly when the political system changed that Finland faced great difficulties. In Estonia, after the change of the political system, the political elite and the leaders of public administration who were related to the Soviet regime were radically removed. However, this explanation is not enough in itself, because the same happened in Latvia (but not in Lithuania). Looking at the cultural and religious background, Estonia and Latvia have Protestant and Lithuania has Catholic roots—meaning that, again, this division is not the same as that existing in their economic performance. Norkus (2012) explores deeper layers, which may offer an explanation. In Estonia, the persistent influence of the Protestant denominations on the indigenous population in the eighteenth–nineteenth centuries can be traced; these denominations were carriers of Max Weber's capitalist spirit, and their cultural impact could be felt in the twentieth century as well. In Latvia, these impacts were overridden by the fact that during the Soviet era, the leading economic position was taken by Russians, and after winning independence, this tendency was even stronger. For the Russians who did not obtain citizenship and who were barred from the public sphere, the only opportunity for emergence was the economy. During privatisation, Russians were not crowded out, as it happened in Estonia because the Latvian economy—as described above—strongly relied on the financial services provided to Russia. In Lithuania, the Jewish minority was

the engine of urbanisation and industrialisation, and an overwhelming majority was killed in WWII. Therefore, at the end of the Soviet era, the majority of townspeople had a rural background; these families did not have any memories of or experience with the operation of a market economy—contrary to the other two Baltic countries.

These explanations seem plausible, and naturally, no outside observer is able to confirm or reject them. Obviously, it would be possible to add more details to this picture. The existing institutional system provides a relatively better source of measurement. In the WEF, competitiveness reports between 2011–2012 and 2013–2014, Estonia ranked 32nd–34th, Latvia 52nd–64th, and Lithuania 44th–48th (Schwab 2013: 15), which confirms that Estonia has the best business environment. As shown above in relation to crisis management, Estonia's government had the best performance and was the quickest to react. A difference in terms of quality between the institutional systems can be seen in the Transparency International's Corruption Perception Index in 2013, in which Estonia takes the 28th (first among the post-socialist countries), Lithuania the 43rd and Latvia 49th. The size of the shadow economy is between 26 and 28 per cent in all three countries (Schneider and Kearney 2013: 4). The most striking difference can be detected in public trust in politicians and in the political system. In the WEF competitiveness report—as far as public trust in politicians is concerned—Estonia ranks 42nd, Latvia 89th, and Lithuania 95th (Schwab 2013: 181, 247, 257). On the basis of Eurobarometer data, Kuokštis (2011) reveals a huge gap between the political legitimacy of the Estonian (on the one hand) and the Latvian and Lithuanian (on the other hand) legislations and governments. This result is very much in line with the present situation, where the population of all three countries, which identify themselves as small, economically and geopolitically vulnerable countries, endures the economic austerity measures, but one part of the Latvian and Lithuanian people emigrate to find a solution. At the same time, greater trust in Estonia provides greater room for manoeuvring for the government; there is a greater chance to find more efficient solutions in economic and social policies, and thereby, they can prevent emigration—which is accomplished under duress, not to gain experience and often becoming permanent—reaches a massive scale. Whatever the deeper historical, cultural, social, and psychological

reasons are, stronger public trust and a better-performing institutional system provide a substantial competitive advantage to Estonia.

8.2 The Visegrád Countries and Hungary's Separate Path

The crisis affected the Visegrád countries differently. Unlike the other members of the EU, Poland did not plunge into recession during the global financial crisis in 2008. It is hardly surprising that Hungary suffered the greatest decline due to the imbalances accumulated before the crisis. It is surprising, however, that the Czech Republic was able to keep its current account and its public debt on a sustainable path of balance, but its growth was not as marked as that of the Polish economy or the Slovakian economy (Table 8.3).

As described in Part II, economic transition began in *Poland* after the political and economic crises of the 1980s. At the beginning of the transition, the situation was even more unfavourable than in the other Visegrád countries. Nevertheless, the first two decades of convergence brought success and economic progress. In 1992, the GDP per capita at PPP was 33 per cent of the EU-15 average, and in 2010, this ratio increased to 56 per cent (63 per cent of the EU-28 average) (Orłowski 2011: 8). The growth rate increased considerably in 2004 and moved above 5 per cent. Exports and investment were the main engines of growth. Although the Polish economy had already been integrated into the European market well before the country formally became an EU member, the accession in 2004 gave new impetus to both exports and to the inflow of FDI. As a result, the current account deficit did not reach 7 per cent, even when it was at its deepest level in 2008, and public debt remained under 50 per cent. Nevertheless, the Polish economy began to show signs of overheating, with increasing current account deficit and inflation in 2006, and the crisis put an end to this.

In 2009, the inflow of FDI and exports drastically declined in Poland as well. The growth of the Polish economy dropped from 3.9 per cent (in 2008) to 2.6 per cent. In 2009–2010, domestic consumption and the

Table 8.3 Some of the major macroeconomic indicators in the Visegrád countries 2004–2013

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment-volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T–1	Nominal unit labour cost index (2010 = 100)—percentage change T/T–1
Poland								
2004–2008 average	5.4	13.5	10.9	46.5	50.7	–4.6	4.8	1.4
2009	2.6	8.1	–1.2	50.9	67.5	–3.9	–14.7	1.1
2010	3.7	9.7	–0.4	53.6	70.1	–5.1	6.0	2.1
2011	4.8	9.7	9.3	54.8	74.7	–5.0	–2.2	1.1
2012	1.8	10.1	–1.5	54.4	74.0	–3.7	–2.4	1.8
2013	1.7	10.3	0.9	55.7	74.9	–1.3	0.2	0.8
Czech Republic								
2004–2008 average	5.5	6.6	6.4	28.4	53.9	–3.4	5.5	1.7
2009	–4.8	6.7	–11.0	34.1	66.0	–2.4	–3.7	2.6
2010	2.3	7.3	1.3	38.2	68.1	–3.9	1.2	0.0
2011	2.0	6.7	1.1	41.0	68.6	–2.7	2.0	0.6
2012	–0.8	7.0	–2.9	45.5	70.7	–1.3	–2.8	2.6
2013	–0.7	7.0	–4.4	45.7	73.7	–1.4	–2.3	0.5
Slovakia								

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment-volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T–1	Nominal unit labour cost index (2010 = 100)—percentage change T/T–1
2004–2008 average	7.2	13.8	8.2	32.7	54.9	–7.1	7.1	2.6
2009	–5.3	12.1	–19.7	36.0	70.2	–2.6	6.9	6.2
2010	4.8	14.5	7.2	41.1	68.7	–3.7	–4.2	–0.9
2011	2.7	13.7	12.7	43.5	71.1	–3.8	1.0	1.1
2012	1.6	14.0	–9.3	52.1	71.2	2.2	0.1	1.0
2013	1.4	14.2	–2.7	54.6	74.8	2.1	0.9	0.3
Hungary								
2004–2008 average	2.7	7.2	3.1	65.4	87.1	–7.9	3.1	3.9
2009	–6.6	10.0	–11.1	78.2	117.5	–0.2	–5.3	2.8
2010	0.8	11.2	–9.5	80.9	116.1	0.2	1.6	–0.3
2011	1.8	11.0	–2.2	81.0	115.4	0.4	–0.4	1.6
2012	–1.5	11.0	–4.2	78.5	101.8	0.8	–2.2	3.5
2013	1.5	10.2	5.2	77.3	95.5	3.0	–1.4	0.8

Source:European Commission (2013a), Eurostat

investments in the public sector became engines of growth. The favourable position of the Polish economy can be attributed to several underlying factors. When the crisis hit the region, it was generally presumed that capital would flee the Eastern European countries, and as a consequence, these economies would collapse. The crisis led to the falling exchange rate of the floating currencies (such as the zloty) in the second half of 2008, and this decline was greater than that of the Hungarian forint or the Czech koruna. The verbal intervention from the Polish central bank and the government in February 2009 and the opening of a flexible credit line by the IMF in April 2009 were effective. The exchange rate of the zloty stabilised at a lower level, which facilitated Polish exports. The Polish market is less open compared to the markets of other smaller CEE countries, which also helped the Polish economy.

The fiscal policy did not have much room to manoeuvre, in spite of the fact that they managed to reduce the general government deficit to 1.9 per cent in 2007. Tax wedge reduction initiated in a good economic situation, increasing the wages in the public sector, and the effects of the measures taken in response to the crisis swung the deficit and public debt. Therefore, the implemented anti-crisis plan was only 0.7 per cent of GDP in 2009 (OECD 2010e: 34). However, government deficit exceeded 7 per cent in 2009 and 2010. With the help of the support received from the EU and the investments made for the purpose of the European Football Championship in 2012, fiscal policy was able to compensate for the decline in private investments. Taking this slow consolidation into account, it is expected to reach the Maastricht criteria in 2015. Public debt did not exceed the 60 per cent ceiling determined both in the Maastricht Treaty and in the Polish Constitution.

The stability of the financial sector had a beneficial effect on the economy as well. The Polish financial supervisory authority intended to curb foreign currency lending by issuing a recommendation in 2006. Due to the prudent regulatory policy and the conservative business models of the banks, the amount of foreign currency debts remained moderate. The Polish financial supervisory authority made the conditions of such lending stricter (Kowalewski and Rybiński 2011). Nevertheless, the risk was still considerable, because in 2012, more than 30 per cent of the outstanding loan portfolio still comprised foreign currency loans (mainly

housing loans in Swiss francs). The negative consequences began to manifest as of January 2015 when the Swiss National Bank announced that it would no longer hold the Swiss franc at a fixed exchange rate with the euro. The Swiss franc began to soar. The proportion of NPL is not insignificant: according to the Polish definition, it was 8.8 per cent in 2012, and it was on the rise. The capital adequacy ratio for the banking sector is above the level required under the Basel III agreement. The foreign ownership of the banking system as a percentage of total assets remained approximately 65 per cent during the crisis years (EC SWD 2013e: 14, 2014g: 43). Property prices increased markedly before the crisis, but their starting point was low, and during the crisis, there was only a moderate decrease in housing prices. The internal and external indebtedness of the private sector was low, and there was no considerable change during the years of the crisis.

Poland has been able to continuously improve its external competitiveness. During the crisis, Poland's global market share remained stable, and in 2013, it exceeded the average of the previous five years by 2.1 per cent. REER deflated by ULC depreciated by nearly 9 per cent in 2012–2013, which ensured that cost competitiveness was enhanced. There was a positive change in the composition of Polish exports in terms of technological intensity, but its extent was below that of the other Visegrád countries (OECD 2010e). Geographical specialisation is very favourable because there has been a huge demand for Polish imports since the beginning of the 2000s in the Russian, Ukrainian, Czech, Slovakian and Lithuanian markets. During the crisis, Polish exports grew more rapidly—in the case of several product categories—than global imports. Experts in the European Commission note that Poland sustained its comparative advantage in low- and medium-low-technology goods, and at the same time, it lacked comparative advantage in medium-high and high-technology goods (EC SWD 2014g: 21).

These results obviously reflect the weaknesses of the innovation system. According to the innovation scoreboard of 2014, Poland is the last country among the moderate innovators, and the country could not use its favourable economic position during the crisis to improve its status. Expenditures of the private sector accounted for 0.33 per cent of GDP, and those of the public sector amounted to 0.56 per cent of GDP

(European Commission 2014c:83). The inadequate performance can be attributed not only to the low amount of expenditure but to the lack of a comprehensive strategy, which would be independent from the successive parliamentary terms, to the lack of coordination between the relevant ministries, to the fact that cooperation is fragile between the actors of the R&D realm and the business sector and to the lack of capital-intensive domestic enterprises (Kasperkiewicz 2012).

Presumably, competitiveness would be enhanced if the privatisation plan initiated in 2008 were accomplished. The economic role of the Polish government remained greater than its competitors' because its ownership is present in the network industries; moreover, in 2008, in the competitive sectors of the economy, there were indeed over 200 firms in manufacturing, and more than 100 mining companies were publicly owned. The planned privatisation has not been accomplished yet, and the government classified 50 firms as strategically important, intending to keep these under majority state ownership and to maintain control (Égert and Goujard 2014).

Due to the favourable results of growth, the unemployment rate is lower than in the pre-crisis period, but it is still approximately 10 per cent. Data concerning employment are biased by the shadow economy in Poland as well, the size of which is estimated to be 24 per cent of GDP (Schneider and Kearney 2013: 4). The most serious problem is labour market segmentation. The use of fixed-term employment contracts is rather widespread, and the transition from these contracts to permanent employment is rare. In addition, almost one-third of them are concluded in the form of a civil law contract, which provides less protection. This situation is particularly disadvantageous for the young: in 2013, 68.6 per cent of the young were employed with fixed-term contracts. According to the PISA surveys, public education in Poland has developed considerably, with students achieving above-average results in all areas. However, labour market data show that there is still a mismatch between skills and labour market needs; therefore, reforms aiming at higher education and vocational training are currently being developed (EC SWD 2014g: 17–19). Due to the economic growth, public spending on education in real terms was higher in 2011 compared to 2008, and as a proportion of GDP, it decreased from 5.7 per cent to 5.6 per cent (EACEA 2013: 4, 7).

As far as labour relations are concerned, the crisis did not bring about changes, and trade union density continued to decrease, reaching 10 per cent in 2013. In Part II, it was discussed that although Solidarity had historical significance, the strength of the trade unions declined in the same way as in the other CEE countries. Solidarity was organised at a corporate level in the state socialist system, which made the decentralisation of concluding the collective agreements easier after the change in the political system. During the crisis there were few strikes, 50–80 on a yearly basis, mainly in the public sector, which were due partly to the privatisation plans. In 2009, the social partners managed to make an agreement on crisis management. The number of negotiations has decreased since, and the government made a decision on minimum pay without negotiating (Krzywdzinski 2012; Eurofound 2014).

The phenomenon of working abroad also contributed to the decrease in unemployment. The number of temporary migrants reached its peak at 2.27 million in 2007; then, their number decreased and stagnated at 2–2.1 million. There are 1.2 million Polish people with migratory experience who returned to their country of origin. The majority of them are pre-accession migrants (Kaczmarczyk 2013: 113–115). In Poland, there has always been a tradition of international emigration. Kaczmarczyk (2013) is not concerned about the return of temporary migrants and considers post-accession migration as a solution that drained the excess labour force of young, skilled workers from the underdeveloped regions. He also points out that the problem rather lies in the fact that these young people leave Poland after completing their education, without gaining any experience in the domestic labour market, but their labour market position abroad is not good, either, because they are overqualified for the jobs they take. Thus, their reintegration into Poland upon their return can be very difficult, which would require well-tailored migration policies.

Not even Poland can be indifferent about keeping the younger generations in the country because the increasing costs of ageing are placing a burden on the Polish economy. It is difficult to phase out the special pensions schemes for miners and farmers because of the potential political conflicts that accompany such measures. In 2013, the government enacted the partial reversal of the systemic pension reform that started

earlier in order to consolidate budgetary expenditures. In 2014, there was a one-off asset transfer worth approximately 9 per cent of GDP from the second pension pillar, that is, from private pension funds to the first pension pillar, and the possibility for further transfers from the second pillar is given (EC SWD 2014g: 7).

The indicators for social inequality slightly decreased during the crisis due to the growth of the Polish economy, but the rate of the severely materially deprived was 11.9 (above the EU average) in 2013 (Table A.8). Social expenditures have been approximately 18–19 of GDP since the outbreak of the crisis, which shows no change compared to the previous years.

The *Czech Republic* also had its share of pre-crisis prosperity; between 2004 and 2008, its economy grew at a pace of 5.5 per cent on average, similar to Poland. Its peak was reached in 2006 at 6.9 per cent; then, in 2008, it slowed down to 2.7 per cent, meaning that the crisis hit the country in a descending branch of a cycle. The extent of the recession, –4.8 per cent, was more favourable than in the Slovakian or the Hungarian cases, but since then, 2012 and 2013 also saw a recession (–0.8 per cent and –0.7 per cent, respectively), which—apart from the Mediterranean countries—was characteristic only of Slovenia, Croatia, Finland, and the Netherlands.

Adaptation to the crisis was supported by both monetary and fiscal policies. The central bank reduced the interest rate on several occasions. The depreciation of the Czech koruna facilitated exports, even if not as persistently as that of the Polish currency did. In 2009–2010, an incentive package was approved in the amount of 2.2 per cent of GDP. Because the government took into consideration the openness of the country, not the demand side was its target—because it would have stimulated imports—but rather the supply side. Because no reserve was accumulated before the crisis, there was no room for manoeuvring for a greater package (OECD 2010a: 40). Due to the decrease in revenue and the operation of the automatic stabilisers, the deficit leaped to 5.5 per cent in 2009; therefore, consolidation began in 2010. The government managed to force back the government deficit to 1.3 per cent by 2013. A slight increase is expected in the coming years, but the deficit likely remains approximately 1.5–2 per cent, and the public debt is fluctuating around 45 per cent.

The Czech banking system did well during the crisis. Since the beginning of the 2000s, prudent regulation, the creation of reserves and supervision—fortunately—has developed gradually in steps. As early as January 2008, financial supervision was already functioning within the Czech National Bank; that is, the same regulation was applied for the entire financial system, which was able to manage the mutual interdependence of the various elements (banks, insurance companies, and savings cooperatives) during the crisis. Because interest rates were low, households were not tempted to borrow in foreign currency loans; the 20 per cent proportion of loans denominated in foreign currency taken out by companies was the lowest in the region. No housing bubble developed, either. The banks (almost 90 per cent were foreign-owned) pursued conservative business policy, and the majority of companies were connected with one bank only, which made risk management considerably easier (OECD 2010a: 33–34). The proportion of NPL is stably around 5 per cent, the capital adequacy ratio of the banks is approximately 15–16 per cent, and their profitability is high; in spite of the recession in the real economy, it was the second highest in the EU in 2013 (EC SWD 2014c: 16, 41).

Products of machinery and transport equipment products account for almost half of the Czech exports, exerting a highly beneficial effect on the competitiveness of the economy; nearly one-third of Czech exports are directed to Germany. Although the proportion of non-EU countries has grown within Czech exports in recent years, the proportion of the EU countries is still above 80 per cent. After the external shock in 2009, the recession that occurred in 2012–2013 was due mainly to the decline in internal demand, and the boosting of export performance is expected to bring recovery. The assessment of the performance of the Czech economy is controversial. On the one hand, after 2009 exports continuously grew in terms of volume and value, but the pace of growth slowed down by 2013. The Czech Republic suffered a 7.7 per cent loss in its share in total global exports during the 5 years before 2013. This is not an outstanding value compared to the other OMS, but it can be seen that only the performance of Hungary is worse (–19.2 per cent) among the Visegrád countries, which are the peer competitors of the Czech economy; Slovakia's loss is only 2.2 per cent, and Poland's share increased by 2.1 per cent. The

REER deflated by ULC increased in the Czech Republic after the 1990s due to the convergence process similar to Slovakia, Hungary, and later Poland from 2004. However, after the currency depreciation in 2009, a more significant and more persistent decrease in REER followed in Poland and Hungary. Although during the crisis, the Czech economy's reaction was less flexible in applying cost reduction than its competitors', this is not the cause of the real problem.

In Part II, it was mentioned that catching up with the EU average had modest results in terms of per capita GDP, and it practically did not take place between 1995 and 2007 in terms of individual final consumption, which expresses the material well-being of a person (Table 4.2). It seems that during the crisis, a persistent recession was needed to stir up the interest of the European Commission, and in February 2014, ECFIN DG as part of its series of conferences held on the individual countries finally put the investigation of the growth in the Czech Republic on the agenda.[2] What struck me as odd was that apart from this conference, I could not find a study in literature that undertook investigating the "mystery" of the Czech economy. I have used the word "mystery" deliberately because, if we compare the potentiality of the Czech economy and its actual growth, I believe it is not far-fetched to speak about a mystery. Based on the average rate of growth in the period between 1993 and 2012, it would take 428 years for the Czech Republic to catch up with Austria in terms of per capita GNI. What is amazing, though, is that all conditions necessary for rapid economic growth according to the economic literature are at their disposal: per capita FDI is the second highest in the region; the savings rate is the first; the macroeconomic environment and the financial system are stable; all key internal and external macroindicators show a long-term balance; the labour force is qualified; its geographical location, that is, the proximity of Germany, is favourable; and social stability is also present (Švejnar and Uvalic 2013; Švejnar and Semerak 2014). The position of the Czech Republic in the various rankings of competitiveness is different. Although its ranking in the WEF decreased during the years of the crisis, according to the GCI, in 2014–2015, again, only Estonia ranked better among the post-communist countries (Schwab 2014:13). In the World Bank's "Doing Business" ranking, the Czech Republic took the 75th place in 2014, over-

taking only Croatia, but in 2015, it was in 44th place (World Bank 2013, 2014). The IMD World Competitiveness Yearbook ranked 60 countries, and in 2014, the Czech Republic took 33rd place; it was second, following Estonia, among the post-socialist countries.[3] Thus, unfortunately, the international rankings cannot help us solve this mystery. The presentations of the participants of the above-referenced conference that were available on the internet do not reveal anything convincing, either. Those factors that are usually brought forward (weaknesses of institutions, primarily those of public administration, corruption, unfavourable demographical processes, and the problems of the educational system)—as we can see later—show neither individually, nor jointly, those attributes that would explain why the performance in terms of convergence is lagging behind the CEE competitors.

OECD experts have pointed out that, on the one hand, the Czech economy is deeply integrated into the German supply chain and, on the other hand, that Czech companies exporting final products use mainly import intermediate products and few products of Czech origin. The Czech Republic is among those OECD countries in which the service content of gross exports is low—similar to all other Visegrád countries; in particular, it is also among those countries that have the lowest domestic content, similar to Slovakia and Hungary. A skill upgrade of the labour force and increasing the services content of the end products would ensure the production of higher added value. A more competition-friendly business environment would be necessary in order to support the domestic drivers of growth (OECD 2014a: 27). It can also be said in the case of the Czech Republic that besides the network industries—where the insufficiency of competition is generally characteristic of Europe—the state owns a considerably large number of companies that operate in the competitive sector. What is even more problematic is that in selecting the members of the companies' management, political considerations prevail over professional ones, and the efficient and transparent supervision of companies' operation is not duly ensured. Nevertheless, the product market regulation and the state's role do not implicate larger difficulties, according to the OECD indicators, than in Poland (see OECD 2014a: 49–81; Égert and Goujard 2014). Regarding corruption, in the ranking of Transparency International, the Czech Republic took the 53rd place

in 2014; Poland, Slovenia, Hungary, and the three Baltic countries gained more favourable places.

With respect to research and development, the Czech Republic is a moderate innovator; of the post-socialist countries only Slovenia and Estonia have better places and are listed as innovation followers in the innovation scoreboard of the EU. In the Czech Republic, during the crisis the expenditures on R&D increased; in 2012, the public sector spent 0.87 per cent of GDP and the business sector spent 1.01 per cent of GDP on R&D, which approximate to the 2.07 per cent average of the EU. Within the business sector, 60 per cent of the funding comes from a few large foreign companies. A shortcoming of the innovation system can be found in the low level of cooperation between scientific research and the business sector. Projects were launched by the government in the framework of its innovation policy in order to facilitate cooperation, but these projects have not delivered the expected results. The efficiency of the innovation policy is impeded by the fragmented institutional system and the very broad scope of the support actions (EC SWD 2014c: 23–24).

The employment rate in the Czech Republic is 70 per cent, which is outstanding in the region, and it was maintained during the crisis. In order to be able to maintain employment, in 2009, partial employment was made possible, with reduced wages, for a maximum of one year. In 2011, with the amendment of the labour code, further liberalisation of the labour market took place. The unemployment rate was approximately 7 per cent and, as expected, it will return to the average 6.6 per cent that it was before the crisis. From the viewpoint of employment, the situation of the Roma population is critical, whose unemployment rate is estimated to be above 50 per cent (EC SWD 2013c: 24).[4] Schneider and Kearney (2013: 4) indicate a significantly lower level of the shadow economy—16 per cent of GDP in the Czech Republic—than in the other post-socialist countries, which is conceivable if we take the high employment rate into account. Czech authors estimate a 20 per cent level on the basis of data from 2008 (Lichard et al. 2012: 11).

The efficiency of the labour market has been impaired by the fact that the evolution of the wages did not follow the structural change in the economy. With the exception of the managers, the proportion and dis-

persion of wages among occupations and within occupations did not change much, except for the high private return on tertiary education degrees. Therefore, the proportion of wages does not indicate what kinds of qualification would be needed from those who enter the labour market. Minimum wages are determined in the collective agreements above the legal minimum (OECD 2014a).

During the crisis, the low level of income disparities increased only minimally (Table A.8), and the data tables of Eurostat show that indicators began to return to where they had been before the crisis changed them. The situation of the Roma population is critical, however; one-third of them are considered socially excluded (EC SWD 2014c: 21). The number of severely materially deprived people was 6.6 per cent in 2013, which remains under the EU average (9.6 per cent). The low level of disparities is explained partly by small and stable wage differences (as mentioned above) because the expenses of social protection remained low, that is, below 20 per cent, even during the crisis.

This evolution of wages is especially interesting because wage bargaining is decentralised, covering approximately one-third of employees. Trade union density is continuously on the decline; in 2013, it was estimated to be 13.5 per cent. Strikes on the level of the companies are very rare; between 2011 and 2012, there were demonstrations with the support of the trade unions against the government reforms concerning the pension and healthcare system and against other measures curbing other welfare benefits. Since 1990, there has been a forum for tripartite negotiations under the name of Council of Economic and Social Agreement (*Rada hospodářské a sociální dohody*), but this is strictly for consultation purposes, without a legally binding force (Eurofound 2014). Cooperative labour relations could not develop, not even through foreign companies. According to the surveys, the majority of the leaders of the large German and Austrian corporations did not strive to implant those direct and indirect participation models into the Czech circumstances, which were highly appreciated at home. This happened only then and there, where the German trade unions or workers' councils fought it out. In the financial sector, Anglo-Saxon corporate managements applied direct participation methods, but their purpose was precisely the crowding-out of the trade unions (Meardi et al. 2013).

During the crisis, in the Czech Republic, it became inevitable to interfere with the welfare system, but curtailing welfare benefits was not of significant size. Nevertheless, independent from budgetary consolidation, ageing itself would explain why the conditions of retirement had to be changed. By 2020, the compulsory retirement age will be 65 or higher, with the exception of a few countries; however, in the Czech Republic, the retirement age is currently 63 years and eight months. Measures taken during the crisis inhibited the increase in pensions in the first pillar only between 2013 and 2015 and improved the operation of the voluntary third pillar, and a new, funded second pillar was introduced. Only few have entered the latter because the missing social consensus makes its future uncertain. In 2013, a new type of early retirement was introduced as well, which does not help curb the expenses related to ageing (EC SWD 2013c: 15–16).

The situation of the Czech education system is quite complex. According to the PISA report of 2012, the results of the Czech students are average in mathematics and reading, slightly above average in science, and only Estonia, Poland and Slovenia are better from among the post-socialist countries within the EU. This result was achieved with relatively low expenses, the public spending on education (4.9 per cent of GDP) lagged behind the EU average by 0.4 percentage points in 2011 as well, although the difference decreased compared to 2008 (EACEA 2013:7). At the same time, in higher education, there was a huge increase: the number of students enrolled in state universities has risen by 32 per cent since the mid-2000s, and the number of students has dynamically grown in private educational institutions as well. Between 2006 and 2012, the ratio of people with higher education qualifications in the age group between 30 and 34 grew from 13.1 per cent to 25.6 per cent. Higher wages related to the degree show that there is a demand for people with higher education, but the fact that the budget of the state universities grew by only 6 per cent during the same period gives rise to quality concerns. The other problem to be solved is the improvement of vocational training, which has been chosen by an extremely high proportion (70 per cent) of the students in upper secondary education. The training programmes for those who do not continue their studies in higher education

are increasingly less suitable for meeting the requirements of the labour market (OECD 2014a: 35–37).

After this review of the institutions with influence on economic growth, let me return to the mystery of Czech economic growth. Half a decade has passed since the beginning of the crisis, and this period seems to confirm what has already been prognosticated by the characteristics of the CEE model in Part II. Convergence built on FDI at a certain level of development can be continued only if the domestic economy is also competitive at international level, but in order to achieve this, it is important to improve the quality of the institutional system (including public administration, the innovation system and the educational system). The Czech Republic did not show worse performance in these areas than its competitors, but because it began from a higher level of development than its competitors, its performance was not enough to achieve more dynamic economic growth.

In *Slovakia* the dynamic growth of the 2000s reached its peak at 10.7 per cent in 2007. During the global economic crisis, its economy shrunk only in 2009, by 5.3 per cent. However, in the other years, there was no recession, and even modest growth could be detected. The Slovak government—similar to those of other countries—intended to mitigate the effects of the crisis using fiscal measures. When the accepted fiscal stimulus package was actually implemented, its impact on the government budget amounted altogether only to 1.0 per cent of GDP in 2009 and 2010 (OECD 2010g: 33). Before the crisis, Slovakia, which was preparing for the adoption of the euro, curbed public spending. However, it did not accumulate reserves, similar to other countries; thus, there was no room for manoeuvring in terms of discretionary revenue measures. Automatic stabilisers were more dominant, and together with the decreasing revenues, they led to a 7.9 per cent deficit. As a result of the consolidation measures, the general government deficit was brought below the Maastricht deficit level in 2013. Since the outbreak of the crisis, public debt has almost doubled, reaching 54.6 per cent in 2013. In the coming years it is expected to be between 54–55 per cent. In 2011, fiscal discipline was strengthened by a new regulation, and the Fiscal Responsibility Board was established.

The Slovak financial system is very similar to the Czech system—it proved to be stable during the years of the crisis. The proportion of foreign ownership exceeded 90 per cent, and deposits were high compared to loans; therefore, the banks were not in need of foreign funding and pursued a conservative lending policy. Capital adequacy ratios of the Slovak banks were already over 16 per cent in 2013, and their profitability has been steadily on the increase since 2011. Foreign currency loans taken for the purchase of housing were almost non-existent. The ratio of NPL was around 5 per cent. (EC SWD 2014y: 44). Property prices soared rapidly before the crisis, mainly because interest rates decreased before entering the euro area; the disposable income of households, however, increased. The supply side, that is, the construction industry, did not grow at the same rate as it did in Estonia or in Slovenia. Overall, it can be said that the property market in Slovakia was not as overheated as it was in many other EU member states, but there was a significant correction in the prices during the crisis. The debt of the private sector was relatively low before and during the crisis, similar to the Czech Republic and Poland.

In terms of per capita FDI, Slovakia is the fourth—following Estonia, Czech Republic, and Hungary—among the post-socialist EU member states, and this did not change during the crisis (Hunya 2013: 40). The inflow of FDI was considerable; consequently, it did not cause any problems in which the current account deficit was around 7 per cent during the years before the crisis. After the shock in 2009, the internal demand declined, but exports began to increase rapidly, the current account ran a surplus of around 2 per cent in 2012, and the European Commission's forecast calculates a surplus of approximately 1 per cent annually in the coming years. Among the Visegrád countries, it is Slovakia whose transport equipment and machinery represent the greatest proportion of exports. Although Slovak exports to non-EU countries have increased, EU countries account for approximately 85 per cent of exports for Slovakia (ECFIN DG 2014h: 21). Slovakia has tight trade linkages with Germany, but Slovak export shares to Germany are only approximately 20 per cent compared to the Czech export shares of above 30 per cent (Fidrmuc et al. 2013: 16). By 2013, Slovakia's five-year global market share in terms of exports has decreased only by 2.2 per cent, which demonstrates the competitiveness of Slovak exports quite well. The competi-

tiveness of Slovak exports has not changed, although REER appreciated steadily before the crisis, and during the crisis, depreciation was more moderate than in Hungary or in Poland. Increasing productivity and the slowing rate of wage growth helped maintain cost competitiveness. The fact that productivity was increasing during the crisis was partly because the less skilled and less productive employees were dismissed first. What made Slovakia's situation even more difficult was that the adoption of the euro took place exactly in 2009, which meant—on the one hand—protection for the open and small Slovak economy, but on the other, the country did not have the opportunity to make use of the currency depreciation during this critical period. According to Fidrmuc et al. (2013), Slovakia entered the euro area with a probably overvalued exchange rate.

Regarding the sustainability of competitiveness, three factors deserve attention. Since the crisis, FDI inflow has declined, although FDI was considered the source of technological convergence in the Slovak economy. Pavličková (2013) provides a detailed analysis of the product structure of Slovak exports between 1999 and 2011. She notes that the Slovak economy has gained strength—in terms of price competitiveness and quality competition—in manufacturing road vehicles (mainly automobiles) and other transport equipment, but this concerns mainly the assembling activity of components, the added value of which is rather low. Slovakia's competitiveness has improved in manufacturing telecommunications equipment as well. At the same time, there has been no improvement in the exports of technology-driven products with higher added value; the structure of exports remained as it had developed in the second half of 1990s. According to Pavličková (2013), the problems presented partly by the innovation system and partly by the labour market and the educational system should be blamed for the unchanged export structure, and she also refers to certain factors related to the government. These problems altogether explain why Slovakia moved downward and dropped 6–15 places in the international rankings measuring the business environment in 2014. These problems are also cited by the analysis prepared by the European Commission on the assessment of the national reform programme: the poor quality of legal regulation and weak law enforcement, frequently changing legislation, corruption and clientele, particularly in public procurement (EC SWD 2014y). In Transparency

International's Corruption Perception Index, Slovakia took the 54th place following the Czech Republic in 2014.

In light of the above, it can be said that the issues of critical importance are the improvement of legislation, the quality of public administration and the development of the innovation system. According to the Innovation Union Scoreboard 2014, Slovakia—as a moderate innovator—performs poorly in terms of the indicators for expenditures, R&D results, economic applications and effects. Total R&D expenditures account for 0.82 per cent of GDP—although there was an increase in 2012—and R&D expenditure in the business sector is 0.34 per cent (European Commission 2014c: 67, 83).

The education system still does not receive enough attention; 4 per cent of GDP was spent on government education expenditures in 2011 (the EU average is 5.3 per cent). However, it can be said that it increased in comparison to the 3.5 per cent in 2008 (EACEA 2013: 7). In the PISA surveys in 2012, the Slovak students performed below average; their results were worse than earlier results. The proportion of those aged 30–34 with tertiary education has increased by more than 10 percentage points since 2008, reaching 26.9 per cent in 2013. The youth unemployment rate has been persistently high (33 per cent in 2013), which means that there is a mismatch between qualifications and labour market needs. The problems of vocational training are expected to be solved in Slovakia by the introduction of the dual system (similar to other countries), the preparation of which is under way (EC SWD 2014y: 19–21).

The unemployment rate continuously declined during the five years preceding the crisis, and it reached its lowest point in 2008 at 9.6 per cent. In 2009, firms received compensation from the government for reducing the working hours, but the unemployment rate exceeded 12 per cent in 2009 and 14 per cent in 2010, and it has not changed much since. Seventy per cent of the unemployed are long-term unemployed. The Slovak employment rate has never exceeded 70 per cent; it has always been approximately 65 per cent. Tackling the underlying factors that explain the unfavourable labour market situation can be even more difficult due to the effects of the crisis. There are great regional differences within the country, with the central and eastern parts lagging behind in particular (reference to these differences has already been made in Part

II), and these differences are reflected in the unemployment rates of the various regions. The regional inequalities are closely associated with the problem of integrating the Roma population. Their employment rate is particularly low, as 80 per cent of adult Roma are outside work. The Roma employment gap is the highest in Slovakia in CEE, while the Roma account for a substantial part, more than 9 per cent of the population (EC SWD 2012c: 19).

Additionally, the unemployment rate is decreasing more slowly than the GDP has increased because the Slovak economy specialises very strongly in capital-intensive, cyclically sensitive sectors. There is a risk here: if the economy does not begin to grow dynamically, unemployment may become structural. The centre-right government of Iveta Radičová intended to make the labour market more flexible, thereby improving employment; thus, the government modified the labour code accordingly in 2011. After the election in 2012, the centre-left government of Robert Fico enacted provisions that strengthened the rights of the trade unions and the protection of the employees, furthermore approximated the different types of taxes related to the various employment forms (EC SWD 2012c; Sikulová and Frank 2013).

The shadow economy has an influence on the Slovak labour market as well. Estimations regarding the extent of the shadow economy are very different from each other. Schneider and Kearney (2013: 4) estimate that the size of the shadow economy is only 15 per cent of GDP, while according to Lichard et al. (2012: 11), it is 28.6 per cent, based on data from 2008. Although a year passed between the publication dates of the two studies, the significant difference cannot be explained. In any case, the low level of employment suggests that the shadow economy is extensive.

Trade union density in Slovakia decreased further during the crisis, from 20 per cent in 2007 to approximately 15 per cent in 2012. There were few strikes: there were three genuine strikes between 2005 and 2010 and one symbolic warning strike in 2011. Collective agreements are concluded mainly at the company level, but there are multi-employer agreements as well, which can be extended to other employers according to certain rules. There are frequent changes in the regulations on whether the employer's consent is needed for the extension (Eurofound 2014). Maintaining a certain level of flexibility is also important because uni-

form collective agreements would not make it possible to set wages that reflect the differences in regional development.

Expenditures on social protection benefits were only 16 per cent of GDP before the crisis and 18 per cent in recent years. Due to the effects of the crisis, the austerity measures affected rather the public sector's wages and the expenditures of the central government. The at-risk-of-poverty rate and the indicators for inequality increased slightly, but the EU 2020 poverty indicator did not (Table A.8). The rate of the severely materially deprived is approximately 10 per cent. In the social field, major changes to the pension system were adopted in 2012 due to the ageing of the population and the resulting problems of sustainability. The deficit of the first, pay-as-you-go pillar was compensated by temporarily reducing the contribution rate of the second pillar from 9 per cent to 4 per cent, and the funding difference was rerouted towards the first pillar. Pension savers were allowed to opt out of the second pillar, and voluntary participation was reintroduced for new labour market entrants, who can decide whether to participate. Calculation of the pensions from the first pillar was made stricter, and the pension regimes for special categories such as the armed forces and police were also curbed (EC SWD 2013j: 13–14).

The reforms implemented in the healthcare system in 2004 could not solve the problems of the sector. Expenditures soared at a large rate, even compared to the international figures, but the same rate could not be detected in the improvement of the health of the population. The budget constraint of state-owned hospitals is soft, the competition between the health insurance funds is modest, and the increase in medicine prices cannot be controlled. The amount of out-of-pocket payments has tripled since 2002, increasing the inequality in the access to healthcare services (OECD 2010g: 57–59). In 2013, the government adopted a new reform programme aiming to tackle these problems (EC SWD 2014y).

In *Hungary*, the 2010 parliamentary election brought a change of government. The right-wing government began to move along a path—evoking many conflicts—that was different from the one usually taken by the governments of CEE after the change in the political system. Thus, processes of the last one and a half decades are detailed in this section. Hungary is the only post-socialist EU member that did not gain anything from the pre-crisis prosperity, and in 2007, economic growth was as low

as 0.5 per cent. The public debt had been increasing since 2002 (it was 51.9 per cent in 2001 and 65.9 per cent in 2007), which was in line with the government deficit moving between 6.4 per cent and 9.4 per cent between 2002 and 2006. The effects of the austerity measures began after the 2006 parliamentary elections and were felt first in 2007, when the deficit decreased to 5.1 per cent. High public debt was coupled with high external indebtedness, increasing from 66 per cent of GDP in 2004 to 120 per cent of GDP at the end of 2008, and the majority of this was private debt. The public debt accounted for 40 per cent. For this reason, investors' confidence was shaken in the Hungarian securities in spite of the results of fiscal consolidation after the outbreak of the global financial crisis, and it became increasingly difficult to sell Hungarian government bonds. The Hungarian forint depreciated by 25 per cent in October 2008. At this point, Hungary required an international loan; thus, a combined credit package of EUR 20 billion was granted by the IMF, the World Bank and the EU in November 2008 (OECD 2010d: 20–22). The government had to continue fiscal consolidation; thus, it could not mitigate the effects of the crisis. The Hungarian economy shrunk by 6.6 per cent in 2009, which was considerably greater than the decline suffered by the Czech or the Slovak economies. The year 2014 was the first in which the rate of growth exceeded 3 per cent; it would then move between 2.5 and 3 per cent. In spite of the fact that the government deficit is kept under 3 per cent, public debt will decrease slowly remaining between 73 and 76 per cent in the years to come.

The Hungarian people became disillusioned with the policy pursued by the Socialist-Liberal governments during the two terms between 2002 and 2010, and Fidesz was elected by a two-thirds majority. Eight years passed, and Viktor Orbán again formed a government.[5] Notwithstanding domestic backup, the new government soon experienced that the EU did not accept that the government would try to stimulate the economy by temporarily loosening the budget. When the government was in opposition, Fidesz viciously attacked those austerity measures of the centre-left government that affected the households. If the government had continued such measures, it would have rapidly led to their losing face. Therefore, the government imposed special taxes on those sectors of the economy that were mainly in foreign ownership. The government

did not want to give up its intention to introduce the 16 per cent flat personal income tax. The earlier mandatory private pension pillar served the purpose of making up for the loss in revenue and paying back the IMF loan. This second pension pillar was de facto eliminated in 2011, which meant a one-off revenue in the amount of 9.7 per cent of GDP (EC SWD 2012a: 12).

The Hungarian banking sector—similar to the CEE countries—was not exposed to toxic assets, and the banks (the majority of them foreign owned) could rely on the help of the parent banks when the international markets showed signs of drying up. After privatisation, there was a decade of considerable growth in profits in the banking sector, but profitability has been declining since 2007. Events took a dramatic turn when the Hungarian forint depreciated drastically against the Swiss franc, and the greatest part of residential housing loans was denominated in Swiss francs. Foreign currency borrowing became widespread after 2003, when home loan subsidies for loans in forints were tightened (because it was no longer sustainable for the government budget), and there were overoptimistic expectations that Hungary would soon enter the euro area. Interest rates were high on forint loans, so it seemed a good idea to obtain foreign currency loans: households borrowed mainly in Swiss francs. Foreign-owned banks were ready to offer foreign currency loans, and later, domestic banks followed suit. At first sight, the Hungarian banking market does not appear to be concentrated, but competition intensity is much lower in retail markets, as observed in case of the loan contracts: households took risks dominantly (OECD 2010d).

The central bank and the Hungarian Financial Supervisory Authority sounded a note of caution, but they could not do much because they did not have any opportunities for action due to legal regulations. The government ignored such warnings and did not want to limit the financial possibilities of the households in this field, especially given the fiscal austerity measures in 2006. After the outbreak of the crisis, the successive governments began active regulation. After 2011, the conditions for obtaining foreign currency loans were as strict as if they had been prohibited. It could not be helped, however, that at the end of 2011, 65 per cent of residential loans were denominated in foreign currency, accounting for 20 per cent of GDP. Its amount was double the Polish or the Romanian

volume of loans (and in the case of Romania, loans were at least denominated in euro) (Hudecz 2013:273).

During the crisis, payment amounts soared and the general economic environment of the firms was unfavourable; therefore, the portfolio quality of the banks deteriorated, and the proportion of non-performing credits or shorter maturity delinquencies elevated. As of 2010, the centre-right government put a huge burden on the banking sector in its fiscal consolidation activity and in solving the problems of foreign currency borrowers, partly in the form of extra taxes, partly in the form of the controversial scheme in 2011 allowing for an early repayment of households' foreign currency mortgages at a fixed exchange rate well below the relevant market rate. The effect of such measures is estimated to be approximately 1¼–1½ per cent of GDP. In mid-2010, the aggregated balance sheet of the commercial banking sector was decreasing, and it came to a halt in 2013. The banking sector made a loss in 2011–2012, but this loss has been borne disproportionately by the banks. The banks that were the most active in providing household loans suffered the greatest loss (ECFIN DG 2014h: 38–40). Foreign-owned banks reduced their Hungarian exposure; in 2012, foreign ownership of the banking system decreased to exactly 50 per cent of total assets of the Hungarian banking sector (EC SWD 2014e: 54). In 2013, the Hungarian Financial Supervisory Authority was integrated into the central bank in order to avoid, in the future, those macroprudential regulatory problems that occurred in the mid-2000s. The review of the foreign currency loan contracts was performed in 2014, enabled by a Hungarian court decision following the preliminary ruling procedure of the European Court of Justice. The court decided that it is unfair for the bank to apply different exchange rates (buying and selling rates) to take out and repay loans (commonly referred to as the exchange rate margin); moreover, as a result of the decision, the unilateral amendment of the agreements can be proved unfair. These consequences are expected to have yet another huge impact on the banking system. Foreign currency loan conversion into forints is expected to take place in 2015, using the central bank's official exchange rate on 7 November 2014. The commercial banks were allowed to obtain the currency necessary for performing the conversion scheme, and the National Bank of Hungary provided the amount from

its reserves. In view of the surge of the Swiss franc in January 2015, it can be said that for all actors, this conversion has been an option by which an even worse situation can be avoided. The conversion scheme included only housing loans, and it excluded all other loans (for example, loans for the purchase of road vehicles or corporate loans). The conversion of consumer and car foreign currency loans will continue in 2016.

The difficulties and problems the Hungarian economy must tackle are not restricted exclusively to the financial system. Hungary suffered a 19.2 per cent decline in terms of export market share during the five years leading up to 2013. Among the post-socialist EU members, higher value was registered only in Croatia. Pre-crisis current account deficit was quite considerable—around 7 per cent—and was eliminated as of 2009 as imports decreased at a greater extent than exports. Since 2013, the accelerating increase of the surplus can be detected. Although since their decline in 2009, exports have been increasing, the data on export market share indicate that there are problems with the Hungarian economy's competitiveness. The reason for this cannot be found in price competitiveness because REER deflated by ULC depreciated steadily during the crisis. The Hungarian export structure is favourable: the share of high-tech products is one of the highest in the EU. The key drivers of exports are machinery and manufacturing transport equipment, and their unit value has been the highest among the Visegrád countries since the beginning of the 2000s; as for the other sectors, Hungary is on a par with the other Visegrád countries. However, the decline in competitiveness can be felt in these sectors as well. The productivity of the Czech and Slovak manufacturing sector exceeded that of Hungary as early as the mid-2000s. As far as product upgrades are concerned, the Hungarian economy lags behind its peers. FDI stock in manufacturing was lower in 2011 than it had been in 2000. In 2011–2012, significant improvements were made in the automobile subsector, and in 2013, the negative trend of losing export market shares reversed. Nevertheless, these improvements could not change the fact that the investment rate is the lowest in Hungary among the Visegrád countries. Hungary is highly integrated into the world economy, with three-quarters of exports going to the EU member states, but the domestic value added content of exports is relatively low. Approximately 75 per cent of exports are produced by foreign-owned

companies, but the Hungarian SME sector remains to be connected only to some extent, spillover effects are low, and the dual structure of the economy survived. The innovation system should be enhanced in order to increase domestic value added (ECFIN DG 2014h: 20–26).

Hungary is among the moderate innovators in the Innovation Union Scoreboard 2014, taking fourth place—following Slovenia, Estonia, and the Czech Republic—among the post-socialist EU member states and occupying the 20th position among all member states. R&D expenditures increased from the pre-crisis 1 per cent of GDP to 1.3 per cent of GDP in 2012. This increase can be attributed to the business sector; in 2012, 0.85 per cent of expenditures were provided by the business sector (European Commission 2014c: 5, 82). Innovation activity is very much concentrated in terms of space and actors alike; innovation is concentrated around mainly Budapest and some foreign-owned firms (ECFIN DG 2014h).

The problems of the Hungarian economy's competitiveness and duality have been known to successive governments. The centre-right government that came to power in 2010 drew the conclusion that recipes aiming at building a traditional, more perfect market (for example, Pina 2014) will not solve these problems and that a more powerful intervention of the government is needed. Although special sectoral taxes were introduced due to the obligation of fiscal consolidation—and were extended to and imposed on the financial, energy, telecommunication, and retail sectors—the government interfered to a greater extent in the economy. The Hungarian Prime Minister, Viktor Orbán, is convinced that the energy prices necessary for competitiveness cannot be reached by strengthening competition but by government-driven price regulation. Obviously, these measures are inseparably intertwined with the intention of holding on to political power. In 2013, residential energy prices were reduced by 20 per cent, which was a trump card for Fidesz: in 2014, Fidesz's party won the parliamentary elections again almost by a two-thirds majority. The government handles FDI in a selective manner and concludes "strategic agreements" with those industrial companies that it considers economically desirable. Not only does the government interfere with and intervene in the economy as a regulator to an extent and in a manner that are unusual in the EU member states, but it also intends

to increase state ownership in those fields considered to be of strategic importance (primarily the energy sector, public utilities, and the banking sector). In order to achieve this aim, the government would go any lengths, and it does not hesitate to make financial sacrifices or to come into conflict with foreign owners. Between 2010 and 2013, the value of state shareholdings doubled (Voszka 2013: 1292). This economic policy has made the Hungarian economy's renown even worse internationally, as detected in the positions obtained in the various rankings of competitiveness (for example, Schwab 2014: 13, World Bank 2014: 4), but for many Hungarians, having disappointed in the capitalist transformation, this economic policy meant certain security and justice against the banks that made huge profit before the crisis, against the energy companies, which were in a monopolistic position, and against the commercial chains, which used their dominant positions against their domestic suppliers.

In the first years of economic transition, the size of the working population decreased by 30 per cent, and the majority of the elderly, Roma and/or low-skilled workers who became unemployed could not enter the labour market again and thereby were in need of the social protection system. Low levels of unemployment became persistent. The crisis further deteriorated the situation, and the unemployment rate, which had hovered around 7 per cent, increased above 10 per cent in 2009. The new role taken by the government can be traced to how it handled the problem of unemployment. According to the centre-right government, the welfare states typical of Western Europe cannot be sustained; therefore, the welfare system must be replaced by the work-based economy known as the workfare system. The activity rate began to rise due to strict measures addressing early retirement, disability pension and certain parts of the social assistance system and to further liberalisation of the labour code in 2012. The government's public work scheme is supposed to make up for the missing jobs in the private sector (EC SWD 2014e: 23). In 2015, the average number of employed in the scheme was approximately 200 thousand.[6] This was the first time since the change in the political system that the government managed to push the employment rate above 63 per cent—with the help of this scheme—which is still well below the EU average (68.4 per cent). The unemployment rate decreased to 10.2 per cent in 2013, and it is expected to go below 8 per

cent in 2015. The indicators for employment are improved by the fact that during the crisis—with the opening of the German and Austrian labour markets—temporary migration sped up. A study found that, at the beginning of 2013, there were 335,000 Hungarian citizens (aged 18–49) who had permanent residence in Hungary but who were staying abroad. Those who move abroad are younger and more qualified than the residents in Hungary (Gödri et al. 2013: 43–44). When the question of employment arises, the size of the shadow economy must be taken into account. According to Schneider and Kearney (2013: 4), this size is not insignificant—22 per cent of GDP—in Hungary. According to Bublik and Tóth (2013: 25), the informal income of the Hungarian population amounts to 17–18 per cent of GDP.

Although the government considers public works a temporary solution due to the structural problems, it is not likely that the market will be able to replace them soon. The employment of the low skilled is invariably a challenge because the newer generations of the young leave school without appropriate qualifications. In the Roma population (approximately 6 per cent of the total), the employment rate has not reached 30 per cent (OECD 2010d: 135). The government wishes to centralise the structure of public education with the intention of elevating the standard of education (in a uniform manner) to a higher level. However, for the time being, the 2012 PISA survey gave an account of the performance of the Hungarian students as below average (EC SWD 2014e). According to EACEA (2013: 7), public spending on education was 5.3 per cent of GDP in 2008, and data for the years after 2008 are provided on a provisional basis: for 2011, it is 5.2 per cent of GDP. According to data provided by Eurostat, the 5.1 per cent in 2008 decreased to 4.7 in 2011. It remains to be seen whether the dual training introduced in 2013 proves to be successful. The reforms concerning higher education came to a standstill before the 2014 parliamentary elections. Although the government remained in power, the already elaborated conception was abandoned and at the end of 2014, and a new proposal was put forward for discussion and accepted in 2015.

The trade unions did not play an important role in the profound changes implemented by the Orbán cabinet in terms of economic and social policies, although there were a few strikes and demonstrations.

Trade union density is only 11 per cent. Collective agreements have shifted to the company level. The forum for tripartite conciliations, the National Interest Reconciliation Council, where negotiations were held on the general increase in the gross wage, was reorganised and converted into the National Economic and Social Council as of 2011. The members of this council included representatives of not only the employer and employee organisations but also other civil organisations (associations for large families, disabled people, and so on) and Churches, and it became a professional advisory board (Eurofound 2014).

In the social assistance system, the austerity measures mentioned earlier have not represented the only important change since 2010. The population of Hungary began to decrease earlier than in the neighbouring countries. In this rapidly ageing country, family policy is at the centre of attention, but the most important means applied are the tax advantages, from which only those with high incomes can benefit. In CEE, only Hungary (and Slovenia) spend a few percentage points more than 20 per cent of GDP on social protection, but this has decreased, reaching 21.8 per cent in 2012. As a result of persistently modest growth, the low level of employment and the flat personal income tax introduced in 2011, the social inequalities increased and the indicators of poverty deteriorated. In 2013, almost one-third of the Hungarian population was below the EU 2020 poverty criteria, and the proportion of severely materially deprived people was 26.8 per cent, which means that the situation in Hungary is far more serious than that in the other Visegrád countries.

Based on Hungary's economic performance, it can be said that the country drifted away from the path the other Visegrád countries took in the second half of the 2000s.[7] As a result of the changes that have been implemented since 2010, the role of the government has come to the forefront to such an extent and centralisation has been performed at such a level in the spheres of public administration, the economy, education, healthcare, and so on that, currently, Hungary's institutional system is also different from that of the other Visegrád countries (Table 8.4). Only time will tell whether the government has been right in hoping that, with the help of the changed institutional system, the country will reach the level of economic performance of the Visegrád countries once again.

Table 8.4 Changes in the institutional systems in the Visegrád countries

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Before 2008						
Liberalised, FDI is dominant in the tradable sectors	Innovation system is below the EU average	Mainly foreign-owned and bank-based	Liberalised at the level of the EU average, active labour market policy has a meagre role	Trade unions have a moderate role	Higher level than in other CEE countries, but social protection is below the EU average	No strongly marked model, low levels of participation in adult education
Characteristic institutional and regulatory features after 2008						
Poland						
Constrained, reluctant privatisation, FDI is dominant in the tradable sectors, domestic value added is relatively low	Moderate innovator	Prudent regulation, a stable banking system, continuous correction in housing prices	Segmented labour market	Trade union density is weakening	Erratic pension reform, weakening the second pillar	Significant improvement in PISA results, higher education and vocational training reforms to improve employability

(*continued*)

Table 8.4 (continued)

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Czech Republic						
FDI is dominant in the tradable sectors, domestic value added is relatively low	Moderate innovator, its innovation potential is not utilised adequately	Prudent regulation, a stable banking system	No change	Trade union density is weakening	Erratic pension reform	Average PISA results, quantitative leap in higher education enrolment
Slovakia						
FDI is dominant in the tradable sectors, domestic value added is relatively low	Moderate innovator	Prudent regulation, a stable banking system, continuous correction in housing prices	Flexibility-enhancing regulation, later stricter EPL	Trade union density is weakening, strengthening the legal status of trade unions	Pension reform restrictions in the first pillar, weakening the second pillar	Below-average PISA results, increase in higher education enrolment

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Hungary						
FDI is dominant in the tradable sectors, domestic value added is relatively low, strengthened regulatory and proprietary roles of the state, sectoral surtaxes in the services sector	Moderate innovator	Foreign currency housing loans weigh heavily on the banking system, surtaxes, tightening regulations after the crisis, continuous correction in housing prices, state ownership is increasing in banks	Liberalisation	Trade union density is weakening	Reduction of social protection, nationalisation of the second pension pillar	Below-average PISA results, centralising of public education to provide a uniform standard quality, introducing dual vocational training, erratic higher education reform

Source: Author's compilation

8.3 The South-Eastern Countries: Enlargement with Croatia

The crisis hit the South-Eastern countries more seriously than the Visegrád countries (with the exception of Hungary) but less seriously than the Baltic states. However, after 2011, growth could not gather considerable momentum, contrary to the Baltic states. Croatia had been sustaining a continuously shrinking economy (since 2009) when it joined the EU on 1st July 2013 (Table 8.5).

Slovenia reached the post-transformation peak of growth at 6.9 per cent in 2007, which dropped to 3.3 per cent in 2008. This rate was followed by 7.8 per cent downturn in 2009. Before the crisis, Slovenia pursued disciplined fiscal policy; public debt was only 21.6 per 21cent in 2008. Therefore, at the beginning of the crisis, a fiscal stimulus package was launched in the amount of 2.1 per cent of GDP (OECD 2009e: 56). Nevertheless, due to the decreasing revenue related to the economic recession and the automatic stabilisers, deficit was increasing rapidly, reaching 6.1 per cent in 2009. Consequently, in 2010, consolidation measures were taken, including but not limited to the delay in the previously decided wage increases. Indexation of the social benefits and pensions first decreased, and then was suspended. General government deficit remained between 4 and 6 per cent until 2012. A dramatic change took place in 2013 due to the restructuring costs of the banks, increasing the deficit to 14.6 per cent. At the same time, public debt reached 70.4 per cent, and it is expected to exceed 80 per cent in the coming years, although the deficit may sink below 3 per cent by 2015. The extended state ownership in the banking sector and in firms with low profitability (especially in the transport sector) presents further risks in decreasing deficit. Slovenia fulfilled its commitment to the EU when it included the basic principles of balanced fiscal policy in its Constitution. However, according to the assessment performed by the Commission, the adoption of the legal regulation suffers a delay, and the efficiency of the fiscal council, which was established in 2009, is limited (EC SWD 2014z).

Pre-crisis credit expansion was covered by the banking sector with foreign funding in the overheated economy, which increased from 9.3 per

Table 8.5 Some of the major macroeconomic indicators of the South-Eastern countries 2004–2013

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment-volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T–1	Nominal unit labour cost index (2010 = 100)—percentage change T/T–1
Slovenia								
2004–2008 average	4.9	5.6	7.7	25.1	85.6	–3.5	0.0	3.0
2009	–7.8	5.9	–23.8	34.5	113.5	–0.5	2.3	8.5
2010	1.2	7.3	–13.7	37.9	115.6	–0.1	–2.6	0.5
2011	0.6	8.2	–4.6	46.2	113.4	0.4	–0.8	–0.7
2012	–2.6	8.9	–8.9	53.4	112.9	3.3	–1.2	0.6
2013	–1.0	10.1	1.9	70.4	101.9	6.3	1.3	1.4
Croatia								
2004–2008 average	4.1	11.2	7.4	36.7	90.5	–6.1	1.4	3.1
2009	–7.4	9.6	–14.2	44.5	118.1	–4.9	1.5	6.9
2010	–1.7	12.3	–15.2	52.8	124.5	–0.8	–3.3	0.1
2011	–0.3	13.9	–2.7	59.9	123.4	–0.8	–2.7	0.6
2012	–2.2	16.1	–3.3	64.4	119.9	0.1	–2.6	–1.3
2013	–0.9	17.3	–1.0	75.7	117.6	1.2	1.2	–0.6

(*continued*)

Table 8.5 (continued)

	Real GDP growth rate, percentage change on previous year	Unemployment rate	Total investment-volume percentage change on previous year	General government gross debt, % of GDP	Private sector debt, consolidated, % of GDP	Balance of the current account, % of GDP	REER—42 trading partners—percentage change T/T–1	Nominal unit labour cost index (2010 = 100)—percentage change T/T–1
Bulgaria								
2004–2008 average	6.5	8.7	18.0	23.4	96.6	–16.8	4.5	6.4
2009	–5.0	6.8	–17.6	14.2	138.4	–8.9	4.0	11.8
2010	0.7	10.3	–18.3	15.9	137.8	–1.5	–2.9	5.0
2011	2.0	11.3	–4.6	15.7	127.9	0.1	1.0	2.4
2012	0.5	12.3	2.0	18.0	128.1	–0.8	–2.0	4.5
2013	1.1	13.0	–0.1	18.3	134.8	1.9	0.1	7.2
Romania								
2004–2008 average	6.8	6.9	18.2	14.6	48.0	–10.1	5.9	13.3
2009	–7.1	6.5	–28.1	23.2	71.9	–4.2	–7.4	3.2
2010	–0.8	7.0	–3.0	29.9	77.8	–4.4	1.6	2.4
2011	1.1	7.2	2.9	34.2	72.9	–4.5	2.8	–5.8
2012	0.6	6.8	0.1	37.3	71.7	–4.4	–6.1	3.5
2013	3.4	7.1	–7.9	37.9	66.6	–1.1	3.9	–1.3

Source:European Commission (2013a), Eurostat

cent of GDP in 2002 to 46.7 per cent in 2008, accounting for one-third of the aggregate balance sheet of the banks (ECFIN DG 2012c: 2, 6). Slovenian banks were hit hard when international lending came to a halt, and they became dependent on the long-term refinancing operations of the Eurosystem, although they did not have toxic assets. The consolidated debt of the non-financial private sector and households was not large—110–120 per cent of GDP compared to the reference value of the EU (133 per cent). However, the level of NPL was high, and this increasing tendency did not stop in 2013, when it was 18 per cent (EC SWD 2014z: 46), and the capital adequacy ratio of the banks was low before the crisis as well. The total assets of the Slovenian banking sector decreased during the crisis from 146 per cent of GDP in 2009 to 116 per cent of GDP in 2013.[8] The government decided in 2013 to intervene and take policy action addressing the stability risks of the banking sector, but already between 2008 and 2012, it spent quite a large amount (2.1 per cent of the 2012 GDP) on restructuring the banks. The Slovenian situation is unique in that the major shares of the banks are state-owned, and there are two domestic privately owned and three foreign-owned subsidiary banks. For the recapitalisation of the state-owned banks, the government spent EUR 3.214 billion, which was followed by EUR 243 million in 2014. In 2013 and 2014, NPL with a gross value of EUR 3.3 billion and, later, EUR 1.087 billion were transferred to the Bank Asset Management Company, which was financed by the issuance of state-guaranteed new bonds. The government intended to reduce its participating interest in the largest bank (NLB) to no more than 25 per cent plus one share. The government was planning to privatise two other banks (NKBM, Abanka) in 2014, but this privatisation must be finalised only in 2015. However, if no capital increase takes place in the two privately owned domestic banks, they may become state-owned banks (ECFIN DG 2014m: 22–23, 2014r: 9–11; European Commission 2014g).

The debts of households did not make the situation worse for the banks; their share in the increase of the credit was modest. Lending by the banks was more prudent towards households than towards companies. Although housing prices had doubled during the pre-crisis years, correction was continuous, and the decrease in real terms was 29 per cent between 2008 and 2013. Presumably, this tendency will continue

(ECFIN DG 2014m: 16). Although the building of houses contributed to the boom of the construction industry, the main drivers were rather infrastructural investments and road construction.

Slovenia's competitiveness was also hit hard by the crisis: REER appreciated in the euro area, and ULC increased more than it did in the Visegrád countries. The adjustment of the wages began in 2012. The declining sales markets of the main destinations of exports (Italy and the former Yugoslav republics) and the composition of exports (dominantly low-tech and medium-tech products with flexible demand) contributed to the fact that Slovenia's global market share decreased. While in the first half of the 2000s, its global market share was expanding, as of 2008, there was a decline, and by 2012, the five-year loss was 20.4 per cent, which could not be compensated by the 3.3 per cent growth in 2013. Slovenian experts have drawn our attention to the deeper processes that are in the background of the facts and figures in Eurostat. Ponikvar et al. (2013: 160) warn that "in the 2001–2008 period Slovenian economic growth was largely a consequence of the growth of low value-added sectors and that this period was not characterised by any notable technological breakthrough". The share of high-tech products in terms of added value lags behind the same share of the Czech, Slovak, or Hungarian economies, although Slovenia joined the suppliers of the German automobile industry. The export-oriented companies of the textile, footwear and woodworking industries were sustained in international competition by setting up "survival coalitions", which meant that the employees accepted lower wages and undertook more work. The more developed companies, for example, in the metallurgical and pharmaceutical industries, worked in a flexible work organisation, and in cooperation with the trade unions, they elaborated the microsystem of competitive solidarity. In order to be able to hold their own in international competition, work intensity had to be increased, which did not really allow for the co-existence of formal and informal work. In Slovenia, after the change in the political system, it remained the common practice that the modest wage of formal work was complemented by the payment received for informal work (Stanojevic 2012). The size of the shadow economy is estimated by Slovenian statistics to be 10 per cent of GDP (EC SWD 2014z: 14), while in the international survey performed by Schneider and Kearney (2013: 4), it is 23

per cent of GDP. Both pieces of data concern the non-observed economy, but the methodology-related reason for this difference cannot be detected from these studies.

Work intensity and the debt of corporations increased before the crisis, and it does not matter whether we compare the latter to the equity of companies (in 2011, 141 per cent) or to their income (OECD 2013g: 14). Therefore, corporations did not have reserves; consequently, many of them suffered a long-term crisis. The ratio for NPL of non-financial corporations increased from 16 per cent to 28 per cent between 2012 and the end of 2013, and the construction and property development corporations were especially affected. However, no industry emerged unscathed. Among the corporations, financial holdings are typically the result of the Slovenian conditions, and they participated in a number of debt-driven management buy out transactions between 2005 and 2007, in the second wave of privatisations. During the crisis, some became insolvent, while others went through debt-restructuring processes. The level of inward FDI stock in Slovenia was the lowest among the post-socialist countries during the crisis: it was only 34 per cent of GDP in 2012. By contrast, 29 per cent of total assets and 27 per cent of total debt were held by state-owned and state-controlled enterprises. Their productivity and profitability are lower than those of privately owned enterprises due to inadequate company management, inefficient state support, and political intervention. In view of this, it is hardly surprising that between 2007 and 2012, state aid granted to the real economy tripled—it was 1.27 per cent of GDP in 2012. The government intended to reduce the level of state involvement, but the privatisation of the previously identified 15 companies is sluggish, partly because it is necessary to perform fiscal consolidation first and partly because of the deficiencies in the legal regulation concerning bankruptcy proceedings (ECFIN DG 2014m: 37–40).

The system of R&D&I depicts a more favourable picture of the possibilities of the Slovenian economy. Slovenia's relative performance to the EU improved from 85 per cent (2007) to 93 per cent (2013), and in 2008, the country moved from the category of "moderate innovators" to the category of "innovation followers". Slovenia is—without doubt—the leading country among the post-socialist countries. A thorough survey of the indicators reveals that Slovenia's results in terms of expenditures

on R&D&I are far better than in the output indicators (European Commission 2014c: 66). This explains why no improvement—expected on the basis of innovation capacity—could be seen in the growth rate of productivity in the pre-crisis years, either.

During the years before the crisis, the unemployment indicators for Slovenia were favourable (below 6 per cent), and the employment rate was over 70 per cent. The labour market performed well, although in the pre-crisis decade, the labour market reforms were erratic. The employment protection of the workers with open-ended contracts remained well over the OECD average, while that of the workers with fixed-term contracts was at the level of the OECD average (OECD 2009e: 112). In the course of the crisis, the unemployment rate was continuously increasing; in 2013, it already reached 10 per cent, and youth unemployment exceeded 20 per cent in 2012. New reforms were introduced in 2013 in order to reduce labour market segmentation and increase flexibility. The first results of these reforms are promising. The Slovenian education system performed fairly well; according to the PISA report, the mathematics and science scores are above the OECD average, but reading skills are below the OECD average. Vocational education and training are in need of further developments, the problem of which is expected to be solved by the introduction of the dual system (EC SWD 2014z: 27–30). Public spending on education was above the EU average, even during the crisis, amounting to 6.7 per cent of GDP in 2011 (EACEA 2013: 7).

Public spending on social protection was the highest in Slovenia among the post-socialist countries, even during the crisis, and indicators for income disparities remained well below the EU average, but they are slowly increasing (Table A.8). In Slovenia, the costs of the ageing society would lay an unsustainable burden on public finances. In 2011, a referendum refused the pension reform and the labour market reform. Nevertheless, at the end of 2012, the parliament adopted a new pension reform. Increasing the retirement age and changing the indexation of the pensions stabilised the costs expectedly until 2020 (EC SWD 2014z).

It seems that the Slovenian society was not prepared for the fact that the separate path, as described in Part II, may reach its end. The Conservative coalition elected in 2004 and led by Janez Janša introduced neoliberal reforms without conciliation with the trade unions, includ-

ing the flat rate taxation, and started privatisation. This disregard for the trade unions has not occurred since the 1990s. The conflict ended in demonstrations, and as a result, both parties suffered considerable losses: the government did not win the parliamentary elections in 2008, and the trade unions lost one-fourth of their membership. During the crisis, the centre-left government did not have other alternative but introduced austerity measures and, thus, found itself in conflict with the trade unions. In December 2011, Janša returned to power after an early general election was held. Janša's government was not popular due to further austerity measures; moreover, Janša received a vote of no confidence and was taken to court, charged with corruption. Janša was followed by Alenka Bratušek. Her government could not win the early general election, and Bratušek, who appointed herself as a nominee for EU commissioner in 2014, was rejected because she was found incompetent. The right wing could not win the approval of the trade unions for the liberalisation and privatisation of the economy; furthermore, it wished to replace the political influence exercised by the post-socialist elite through state-owned properties with its own influence exercised through its own clientele (Stanojevic 2014). Naturally, it will come as no surprise that in the WEF competitiveness report, Slovenia is ranked number 133 out of 144 countries as far as "public trust in politicians" is concerned (Schwab 2014: 339). Dissatisfaction of the voters with the whole political elite was demonstrated rather well when a six-week-old party won 35 per cent of the vote in the 2014 election and when a centre-left coalition was formed as a result.[9] Nevertheless, it is not likely to be enough to stop the deterioration of the Slovenian model, which has been based on neo-corporatist agreements and strong state involvement. The government is not able to give up privatisation, and trade union density is gradually shrinking: in 2013, it was estimated to be 20 per cent. Collective bargaining is still performed at the sectoral level, but the affected sphere is narrowing, and there is a tendency towards decentralisation (Eurofound 2014). If the political division of society does not hinder the change in the economy, Slovenia's institutional system will presumably be similar to that of the Visegrád countries. However, due to the legacy of the previous decades, it is likely that social protection and social partnership will have a relatively greater role in Slovenia than in the Visegrád countries.

Croatia joined the EU on 1 July 2013. Similar to the case of the non-EU member states of the Western Balkans, not much attention has been devoted to Croatia's institutional system in the VoC literature. Croatia's historical legacy is similar to that of Slovenia: Croatia was also part of Yugoslavia and had earlier belonged to the Kingdom of Serbs, Croats, and Slovenes, to the Austro-Hungarian Monarchy until its collapse in 1918, and to the Habsburg Empire beginning in the sixteenth century. Its culture is also similar to Slovenia's culture in that it adheres to Roman Catholicism, in contrast to the other Western Balkan countries, where the principal religions are Orthodox Catholicism and Islam. At the same time, economically, Croatia was less developed than Slovenia; significant industrialisation took place only after the WWII. During the Yugoslav period, per capita GDP decreased from 66.7 per cent of Slovenian GDP in 1952 to 64.1 per cent of Slovenian GDP in 1989 (Gligorov 2004: 27). Similar to Slovenia, Croatia, as the second-richest republic of the socialist Yugoslavia, also had an interest in breaking free from the declining economy, the presence of which has been described in relation to Slovenia in Part II. Croatia declared its independence from the Socialist Federal Republic Yugoslavia on the very same day as Slovenia, on 25 June 1991. However, the war that followed was not a ten-day-long war, as it was in Slovenia. The Croatian War of Independence was fought for four years partly in its own territory (which was claimed by the Serbian minority, which established the Republic of Serbian Krajina), partly in Bosnia-Herzegovina, which became independent and was populated by Bosnians, Serbs, and Croats. At the end of 1995, the war ended after an agreement was signed in Dayton (Ohio, USA). In addition to its human and financial losses, the war distorted the entire Croatian economic and political transformation. The war destroyed one-third of Croatia's industrial capacity and 10 per cent of housing, and the Yugoslavian market as such ceased to exist (Bartlett 2003: 88–89). In 1997, Croatian per capita GDP was only 47 per cent of the per capita Slovenian GDP (Gligorov 2004: 27); in 1998 the estimated level of real GDP was 78 per cent of the 1989 GDP (EBRD 1999: 73).

In 1990, the first multi-party election was won by the Croatian Democratic Union (*Hrvatska demokratska zajednica*) led by Franjo Tuđman, who was re-elected President twice and who remained in power

until his death in 1999. Tuđman took part in the political movement known as the "Croatian spring" in 1971, which called for more rights for Croatia within Yugoslavia. The communist President, Josip Broz Tito (born to a Croat father and Slovene mother) repressed the movement out of fear that nationalism would gain strength and that Yugoslavia might fall apart. Tuđman remains a controversial figure because, after the independence of Croatia, Tuđman used the economic transformation to build his political clientele. He refused to cooperate with the International Criminal Tribunal for the former Yugoslavia, which led to the international isolation of Croatia (Bartlett 2003). The issue of the war crimes cast a shadow on the accession of Croatia to the EU. Negotiations stopped until the accused persons were surrendered (that is why the less developed Romania and Bulgaria joined the EU earlier than Croatia); however, the majority of the Croatian population considered the accused national heroes rather than war criminals. Croatia was made an official candidate in 2004, and the accession negotiations began in 2005, after the last accused person was delivered.

After the 1990 election, the right-wing government adopted an act on mandatory privatisation as early as 1991 and rapidly accomplished it accordingly in the midst of the war. Its primary form was management buy out; voucher privatisation was only secondary. Contrary to Slovenia, Croatia did not want to build on the tradition of relatively autonomous self-management, preferring to impede the cooperation between the post-communist managers and workers (Bohle and Greskovits 2012). The literature is entirely unambiguous in revealing that during the privatisation process, the obtained properties had political connections and supported the government (for example, Bartlett 2003; Bohle and Greskovits 2012; Cvijanović and Redžepagić 2011).[10] The same methodology can also be seen in other post-socialist countries. State-owned banks provided loans for the buyout, and these were paid back from the profits of companies, or the assets of companies served as coverage for these mortgages. In most cases, the new owners strived to maximise short-term profits, and instead of implementing long-term management, they depleted the gained property and went bankrupt; as a result, in 1998, the whole banking system experienced a crisis. Within a few years, the greatest part of the banking

sector was owned by Italian and Austrian banks (Bartlett 2007). Similar to the other post-socialist EU member states, Croatia's financial system is bank based. FDI played an important role in the transformation of Croatia as well (similar to the other post-socialist EU member states), but its dynamic inflow began only after the accession negotiations had commenced. Since then, the FDI stock has exceeded 50 per cent of GDP, which is on par with the average of the other ten post-socialist countries. However, the composition of FDI is not really favourable because the majority of FDI flowed into the non-tradable sectors (financial intermediation, property development, and construction) and, within industry, into processing raw materials rather than into more technology-intensive sectors (Hunya 2013: 41, 99). In line with the above, Croatia is among the moderate innovators. After Croatia joined the EU, the country was included, for the first time, in the innovation scoreboard, taking the 23rd place (European Commission 2014c: 5).

After the change in the political system, the unemployment rate began to decrease in the mid-1990s, but due to the failure of the first wave of privatisation—as described above—unemployment increased again. Better growth performance in the 2000s somewhat improved the situation in the labour market, but the rate of unemployment dipped below 10 per cent only in 2008, when the crisis began. The Croatian labour market was among the most rigid at that time in terms of EPL; only the Mediterranean countries showed higher values. Croatia's EPL was higher than those of the post-socialist countries, even Slovenia. Croatian EPL was strict in the case of open-ended contracts and in the case of fixed-term contracts (World Bank 2011: 17–18).

The evolvement of labour relations was similar to that of the Romanian and Bulgarian situation rather than the Slovenian situation. The Croatian government considered the traditions of self-managed companies a threat rather than an opportunity, and no corporatist cooperation developed. The tripartite social dialogue was established legally in 1994, and the Economic and Social Council was set up. In 2000, the centre-left government came to power, and it tried to conclude a comprehensive agreement with the social partners, but this attempt failed because certain trade unions had withdrawn. Trade union density remained considerable (35 per cent) compared to the other EU members, but currently, this

figure exists only because density in the public sector was 70 per cent. Coordination between the highly fragmented trade unions is low, wage bargaining is decentralised, and agreements are concluded at the company level (Eurofound 2014).

The welfare system was quite developed in Yugoslavia, and its administration was performed in a decentralised way. This facilitated the launch of the social protection system in the post-Yugoslavian independent states. Croatia, like its peers, had to face the same social challenges brought about by the economic transition, but in addition, it had to cope with the consequences of war, including the resettlement of refugees and displaced persons, the integration of territories that returned as the result of the Dayton Accords and the reintegration of war veterans into civil society. In 1998, public expenditure on social protection increased to as much as 28.1 per cent of GDP (Bejaković and McAuley 1999: 7). The operation of the welfare system and the structure of social expenditures were politicised as well, characterised by prevailing political considerations, the building of clientele and selective support for political adherents. Expenditure on pensions accounts for an outstandingly high amount of social spending. Croatia introduced the three-pillar pension system at the beginning of the 2000s in order to decrease its fiscal burden. Before the crisis, public expenditures on social protection decreased to 18.7 per cent of GDP. In the last decade, public spending on education was approximately 4 per cent of GDP, 1 percentage point lower than the EU average, and Croatia is planning to implement cost-cutting measures in the coming years. In the PISA tests, Croatian students performed below average, but showing no significant difference from the performance of Slovakian, Lithuanian, Latvian, and—more recently—Hungarian students. In the last five years, the proportion of those participating in higher education has rapidly increased, but the proportion of young people aged 30–34 with higher education degrees is still 11 percentage points lower than the EU average (in 2013, it was 25.7 per cent). The composition of higher education is not favourable; the proportion of those holding a degree in engineering or in medicine is decreasing. In the case of those with degrees and in the case of skilled workers, one-third and, in some fields, half of those who enter the labour market are not employed in a job that matches their field of study. The implementation of the reforms covering

several sectors of the education system and hopefully tackling the problems has been delayed (Bartlett 2007: 213–214; EC SWD 2014b:26–27, 50; OECD 2013j: 5).

The crisis drew attention to the structural weaknesses of the Croatian economy, which suffered considerable loss in 2009; moreover, since then, through five successive years, the economy has shrunk by a total of 12 per cent. Recovery was expected to begin only in 2015. During the crisis, fiscal policy was loosened, and government deficit shifted approximately 6 per cent between 2009 and 2013, decreasing to 5.2 per cent in 2013. Public debt was 36 per cent in 2008; after that, it began to increase rapidly, and in 2013, it reached 75.7 per cent. The dynamism of this growth has slowed down, but it did not stop; by 2016, it may reach 90 per cent of GDP. There is a risk in decreasing public debt, namely, that the share of foreign currency debt in public debt is high (in 2013, it was approximately 75 per cent, ECFIN DG 2014c: 43), and the losses of the state-owned companies and the state guarantees granted to them (mainly in the fields of highway construction, railway infrastructure and shipbuilding) mean contingent fiscal liabilities. The assessment of budgetary development is complicated because the Croatian statistical system is currently, that is, after the accession, in the process of adopting the European System of Accounts. Budgetary planning as such has been strengthened by several acts since 2009; in 2011, a fiscal council was established, but the effects of these measures have not been felt strongly yet. In planning, the government tends to be overoptimistic, which leads to frequent budgetary revisions (EC SWD 2014b).

Total assets of the banking sector were 130 per cent of GDP in 2013, which means that Croatia has the fourth-largest banking sector (after Cyprus, Malta, and Slovenia) in Central and South-Eastern Europe. State ownership is limited, representing only approximately 5 per cent of total banking assets. The banking sector remained stable during the crisis, and capital levels are among the highest in the region. The Croatian National Bank adopted a conservative approach during the years of pre-crisis prosperity, and using macroprudential measures, it aimed to slow down the pace of credit growth and the expansion of the ratio of foreign-currency-denominated loans. These measures strengthened the resilience of the banks during the crisis. The degree of financial euroisation in Croatia

is among the highest in the world; thus, maintaining a broadly stable exchange rate of the kuna against the euro has been a key element of Croatia's economic policy strategy. This exchange rate regime was like a tightly managed float, which could sustain even in the most critical years of the crisis. Nevertheless, indebtedness of the private sector could not be avoided. However, this indebtedness was characterised mainly by external borrowing, which was performed directly from the foreign parent banks of Croatian subsidiaries; thus, the parent banks took the risk. Due to the crisis of the real economy, the ratio of NPL increased from 5 per cent in 2008 to 15.3 per cent in 2013 and, in the corporate sector, to 27.4 per cent. Deleveraging began in the private sector. Due to the reduced demand for credit from the private sector, banks have compensated by increasing lending to public entities and state-owned enterprises. Obviously, the above-demonstrated situation of public finances presents further risks (ECFIN DG 2014c: 45–53).

Household debt peaked at 42 per cent of GDP in 2010. Compared to those of the Western-European countries, this rate is not high, but in 2012, it was still 6 percentage points higher than in the ten CEE countries. Households were not in an easy situation considering that property prices had decreased by 30 per cent between 2008 and 2013 and that Swiss franc-indexed housing loans accounted for 40 per cent of all loans. When the Swiss franc surged in January 2015, the related risks became reality. During pre-crisis prosperity, the debt-to-GDP ratio of the corporate sector more than doubled, which—after the narrowing of the export markets and the decline in domestic demand—further surged by 30 percentage points, reaching the peak at 95 per cent in 2010; its decline is slow. Corporate debt of Croatia also exceeds—by 7 percentage points—that of the ten competitor CEE countries (ECFIN DG 2014c: 34, 36, 39).

The problems related to the competitiveness of the Croatian economy can be found in the background of the protracted crisis. Croatia's pre-crisis economic growth was already accompanied by imbalances, and the current account ran a 6 per cent deficit. It originated from the deficit of the export of goods, and services, including the country's considerable tourism, could not compensate. The loss of its export market share began in 2004, and between 2008 and 2013, it reached 20.9 per cent.

The process took a turn in 2013, when a growth of 3.4 per cent was registered. There are several factors in the background of market share loss and weak competitiveness. Croatia's main export markets (Italy, Bosnia-Herzegovina, and Slovenia) were also hit hard by the crisis. When Croatia joined the EU, the country exited the Central European Free Trade Agreement, which means that they have limited access to some regional markets. Its exports were concentrated on goods for which the demand declined considerably. As mentioned, Croatia has not accomplished the industrial restructuring the Visegrád countries did with the help of the FDI; therefore, Croatia could not integrate into the global value chain. Croatian experts agree that one of the main problems of the Croatian economy is the drastic decline in the manufacturing industry (Cvijanović and Redžepagić 2011). ULC increased more slowly than in the competitor countries, but this began from a high level and was more intensive than that of productivity. REER demonstrates the disadvantageous position of cost competitiveness compared to the ten post-socialist countries, especially in the industrial sector. The regulation of the product market is more rigid than that of regional competitors, but it does not show considerable differences compared to pre-accession data on its regional competitors (De Rosa et al. 2009). The state maintained ownership to a considerable extent; at the end of 2013, there were 59 state-owned companies of strategic interest and 561 companies awaiting privatisation. Privatisation is proceeding slowly, but certain advances have been made, especially in selling tourism-related facilities, former military properties and shipyards. The privatisation contracts of the latter properties include restructuring aid as well. Competitiveness rankings assessing the business and institutional environment (made by the World Bank, the Heritage Foundation and the WEF) demonstrated clearly that the Croatian economy underperformed the CEE-10 (EC SWD 2014b: 31–32; ECFIN DG 2014c: 31).

As a result of the crisis, the unemployment rate increased substantially; since 2012, it has exceeded 15 per cent (as it did at the end of the 1990s), and it is approaching 18 per cent. Youth unemployment was 50 per cent in 2013. Since 2010, the employment rate has been the lowest in Croatia (besides Greece) within the EU. Most jobs were lost in the construction industry and manufacturing. The decline in employment is exceeding

the economic decline, in which the rigid labour market and the regulation of social assistance play a role, as it creates disincentives to work (even a low income means that eligibility for social benefits is lost). Rigid labour market regulation and high dismissal costs led to the increase in fixed-term contracts, the segmentation of the labour market and informal employment. Estimations of international organisations concerning the size of the informal economy move between 25 and 40 per cent; according to Schneider and Kearney (2013:4), it is 28 per cent. Since 2013, the government has been trying to make the labour market more flexible and to decrease its segmentation through a series of reforms. It is difficult to gauge the effects of the changes so far; the content of the reform measures of the second phase launched in 2014 have not been elaborated yet (EC SWD 2013a: 17–19, 2014b).

The crisis increased social inequalities; in 2013, 29.9 per cent of the Croatian population was below the EU 2020 poverty criteria, even though it had been 2.7 percentage points higher in the previous year. The rate of the severely materially deprived was 14.7 per cent in 2013, which means some improvement to the 15.9 per cent of 2012. It is not certain how persistent this improvement will be because further austerity measures are planned for the coming years in terms of social protection-related costs, which accounted for 20–21 per cent of GDP during the years of the crisis. The three-pillar pension system is undergoing changes in order to conduct fiscal consolidation. In 2014–2015, funds in the total amount of 1.4 per cent of GDP are rerouted from the second to the first (state) pillar, and social security contributions transferred to the second pillar will be decreased. In 2016, transfers from the state to the third—voluntary—pillar will be eliminated. After 2011, some structural reforms were also made because social transfers and the system of pensions were fragmented. There were more than 70 types of legal entitlement upon which it was possible to receive welfare provision. This was restructured by an act in 2013, and the investigation of means-testing was given greater emphasis. The introduction of the guaranteed minimum benefit has been delayed. The integration of the pension system is made more difficult by the fact that special pensions for veterans, former political prisoners, military personnel, and other beneficiaries account for 20 per cent of overall pension expenditure. For this reason, the government is

attempting to apply incentives to keep people working and to extend the actual date of retirement (EC SWD 2013a: 15, 2014b: 9–10, 24–26).

Until this day, Croatia has not recovered entirely from the damages caused by the war in the first few years of the economic and social transition. Its economic performance and its institutional system rank somewhere between Slovenia and the other two South-Eastern European countries: Romania and Bulgaria. It remains to be seen whether Croatia will be able to find its way back to its historical roots, which would once again make the country more similar to the Central-European region.

Romania was in a prosperous period of growth when the global financial crisis occurred—the average rate of growth was above 6 per cent after 2001. Nevertheless, large imbalances accumulated in the background of the spectacular results, exactly as it happened in other countries as well. Growth was based mainly on private consumption, which was financed by the inflow of foreign capital. Moreover, this growth was enhanced by a pro-cyclical fiscal policy. As a result, current account deficit reached an average 10 per cent between 2004 and 2008, and the government deficit increased to 5.6 per cent by 2008. Investments of the private sector were financed mainly from foreign currency loans. Euroisation was high in Romania; more than 50 per cent of transactions were euro-denominated, which meant that exchange rate devaluation—as a tool applied by economic policy—could be used only to a limited extent during the crisis (Dăianu and Murgescu 2013: 14). When the crisis hit the country in 2008, the inflow of FDI decreased dramatically. This led to such a significant external funding gap that Romania had to apply for international assistance. In May 2009, an agreement was concluded on the joint financial assistance programme provided by the EU, the World Bank, the EIB and the EBRD, amounting to a total EUR 20 billion. In return, Romania had to implement an adjustment programme. Romania requested that the EU and the IMF launch a precautionary financial assistance programme (with a financial framework of approximately EUR five billion altogether) as a follow-up to the previous two-year-long programme. In 2013, it was decided that due to the remaining risks, a third precautionary financial assistance programme was needed until 2015, which meant a financial package in the amount of EUR four billion (European Commission 2013c: 13, 2013d: 1).

Significant adjustment took place in the Romanian economy, the current account deficit sank below 2 per cent by 2013, and it is expected to remain at this level in the coming years. Government deficit decreased to 2.2 per cent, but public debt increased by 25 percentage points between 2008 and 2013; however, this debt was still only 37.9 per cent of GDP. Due to the depreciation of the lei and the moderate increase in wages costs, between 2008 and 2013, REER weakened by 15 per cent, enhancing the price competitiveness of the Romanian economy and compensating for the pre-crisis appreciation. Between 2008 and 2013, the global export market share of Romania increased by 16.4 per cent. Romanian exports account for 40 per cent of GDP, which is the lowest ratio compared to the country's CEE competitors, and Romania was less integrated into the international business network. The stock of per capita FDI had been increasing dynamically before the crisis, but it was only half of the average of the ten CEE NMS in 2012. In the composition of FDI, there are favourable processes, however. Nearly one-third of FDI flowed into the manufacturing sector—which is the main export sector—similar to the Visegrád countries. Fifty per cent of total exports are knowledge intensive, which is slightly below the EU weighted average (55 per cent); however, it exceeds by far the level of the Baltic countries, Bulgaria and Croatia (European Commission 2013d: 10, 29–30; Hunya 2013: 40, 83). This ratio is due to the presence of FDI. The Romanian innovation system is invariably among the most moderate innovators in the scoreboard of the EU, and R&D intensity weakened in the midst of the crisis-evoked austerity measures. In 2008, R&D spending was 0.58 per cent, and the input of the business sector was 0.17. In 2012, according to the innovation scoreboard of the EU, Romanian R&D expenditures in the public sector were 0.3 per cent, and the comparable figure in the business sector is 0.12 per cent. Duality of the domestic and foreign corporate sector is demonstrated rather well by the fact that the latter provides more than 70 per cent of exports. At the same time, microenterprises account for 90 per cent of all companies, and the majority of the SME sector is concentrated in low-value-added areas with specialisation in labour-intensive industries. Productivity in the Romanian economy as a whole remains at 60 per cent of the EU average (EC SWD 2013f:26–27; European Commission 2013c: 20, 2014c: 83).

The competitiveness of the Romanian economy is weakened by the problems of the business environment, those of public administration and the economic management of state-owned companies. More than 900 state-owned companies account for 9 per cent of output and 10 per cent of employment; their role is considerable in the energy and transport sectors. Among the EU member states and even compared to the OECD average, the size of the public enterprise sector is the largest in Romania—besides Slovenia (De Rosa et al. 2009: 22). The difficulties Romania's economy must face are well demonstrated by the following figure: the arrears of state-owned enterprises have been halved due to the reform programmes; however, they still accounted for 2 per cent of GDP in 2013 (European Commission 2013c:6). Attempts have been made towards the appointment of professional management, but the results are limited because political considerations often prevail over professional ones. Privatisation has been proceeding slowly—often due to the lack of interested applicants—and the authorities do not seem very resolute in this matter, either. According to the international competitiveness rankings, inefficient bureaucracy is one of the major shortcomings in the Romanian business environment, and in the period between 2013 and 2015, improving public administration is still in the centre of the structural reforms, which are the pre-conditions of the financial support provided by the EU-IMF (European Commission 2013d, 2014f). The need to improve public administration is also underlined by the fact that Romania's absorption rate was 20.2 per cent at the end of 2012, which means that during the seven-year budget period, Romania could absorb only one-fifth of all EU funds (EC SWD 2013f: 3).

The Romanian banking system was also adversely affected by the crisis of the wholesale funding and the double-digit loan growth, followed by deteriorating asset quality. The housing bubble burst in 2009, and the annual decrease in housing prices was between 20 and 10 per cent for four years. The ratio of NPL increased from 2.8 per cent in 2008 to 21.6 per cent in 2013 (EC SWD 2013f: 39, 2014h: 46). Nevertheless, neither the ratio of NPL nor the capital adequacy ratio of the banking sector underperforms Romania's competitors in the region. Within the framework of the financial assistance programmes, measures were elaborated to ensure the stability of the banking system (strengthening the Deposit

Guarantee Fund and the regulations concerning bank resolution, limiting household and SME loans denominated in foreign currency, and regulating the non-banking sector). Eighty per cent of the Romanian banking sector was foreign owned, and among these, there are nine core banks, the parent banks of which belong to the euro area. In the context of the European Bank Coordination Initiative—also known as the "Vienna Initiative"—these parent institutions committed to providing capital support and to maintaining their overall exposure to Romania in the first phase of the programme. As a result, deleveraging has been orderly. However, in the medium term, the Romanian exposure of the nine banks has been limited by the parent banks; their exposure shrank to 86 per cent in 2013 (if 2009 is taken as the benchmark level), and funding provided by the parent banks has decreased as well. Foreign ownership of the banking system accounted for almost 90 per cent of total assets before the crisis, but by 2012, it sank below 70 per cent (European Commission 2013d: 12; EC SWD 2014h: 46).

The unemployment rate remained around 7 per cent even during the crisis, which is a favourable piece of data in itself. However, the employment rate among those aged 20–64 years was below 64 per cent, which is quite low within the EU. Worse performance (by 5 to 10 percentage points) was registered only in the case of the Mediterranean economies. Young people are in a difficult situation in Romania; youth unemployment was 23.6 per cent in 2013. The lack of integration among the Roma population is demonstrated by a very highrate of unemployment (48.6 per cent). Romania had the highest share of employment in agriculture in the EU before the crisis. This ratio increased further, reaching 28.6 per cent in 2011, which has an unfavourable effect on the labour productivity level of the economy (EC SWD 2013f: 16). In 2011, the Romanian government intended to make the labour market more flexible by modifying the labour code. Nevertheless, only suppressing the shadow economy would achieve a major breakthrough. Romania has one of the lowest ratios of budget revenues relative to GDP in the EU; however, a relatively high tax burden is laid on the low- and medium-level incomes. This also explains why employment statistics represent 9.4 million people, while according to the data, 4.3 million people contributed to the social insurance funds in 2012, and 1.2 million of them were employed in the public

sector. The rapidly ageing population is another especially severe problem. Romanian experts estimate that the size of the shadow economy is approximately 25–30 per cent of GDP (Dăianu and Murgescu 2013: 18–19), which is entirely in line with the estimations (28 per cent) made by Schneider and Kearney (2013: 4).

The limited employment possibilities, the huge difference in wages and free movement within the EU all motivated mainly the younger generation to go abroad for work. It is not easy to determine the extent of the Romanian labour migration,[11] and it is especially difficult to determine how many of those who took temporary jobs abroad will return. According to the national censuses, the population decreased from 21.68 million to 19.04 million between 2002 and 2012, and emigration plays an important role in this reduction. Highly skilled emigrants tend to head to the Northern countries, while those with or without vocational education usually go to Spain or Italy, where the national languages are related to Romanian. Emigration played an important role in the pre-crisis wage increase and the consumption-driven growth through the decrease of labour supply and remittances. Remittances have decreased since the crisis, but their amount still reached 3 per cent of GDP in 2009 (Mereuta 2013: 130–133).

Budgetary consolidation was accompanied by tough austerity measures in 2010, such as a 25 per cent reduction in wages in the public sector, a 15 per cent reduction in all social benefits and a freeze in pensions. The Romanian pension system was already a three-pillar system before the crisis; in 2010, the retirement age was elevated to 65 years in the case of men and 63 years in the case of women. The unpopular measures evoked demonstrations, which led to the resignation of the centre-right government in 2012. In spite of the series of government crises, in 2011, the government pushed through the above-mentioned amendment of the labour code and the reform of social dialogue, although the trade unions protested. The national-level collective agreements were abolished, and collective agreements were made primarily on the company level and second on the sectoral level. Weakening of the corporatist institutions is shown by the fact that although dissatisfaction manifested in political protests, the number of strikes and the number of participants in them have been declining continuously since 2008; trade union density weak-

ened to approximately 35 per cent in 2013 (Eurofound 2014; European Commission 2013c).

The performance of the Romanian students improved compared to their earlier results, according to the 2012 PISA survey; nevertheless, Romania is among the lowest-ranked EU member states (OECD 2013j: 5). In 2011, an act on education was passed, aiming to improve the quality of education in the long term on all levels. In order to align the trainings with the needs of the labour market, vocational training must be developed considerably, and, again, the dual training system is expected to solve this problem. Unfortunately, the realisation of the reform measures is proceeding very slowly (EC SWD 2014h). Public spending on education (4.5 per cent of GDP in 2008) decreased to 4.1 per cent in 2011, which obviously does not support the accomplishment of the reforms (EACEA 2013: 7).[12]

The poverty-related indicators have not yet reached the level of 2007, but due to the austerity measures in 2010, some of the improvement achieved after the EU accession has been lost. Romania still has enormous tasks in eradicating poverty; in 2013, 40.4 per cent of the population was below the EU 2020 poverty criteria, and 28.5 per cent of the population was considered severely materially deprived. If Romania succeeds in achieving the expected growth, the modest but continuous decrease in the latter category can be maintained.

Growth in *Bulgaria* was approximately 6 per cent in each year between 2004 and 2008, which was followed by a 5 per cent decline in 2009—the lowest among the four South-Eastern European EU member states. Since then, the growth rate has been positive in each year, but it shifted between 0.7 and 2.0 per cent and is expected to remain in this range in the coming years. Impressive growth was accompanied by high current account deficits, which exceeded 25 and 23 per cent in 2007 and 2008, respectively. In 2009, the deficit decreased rapidly; between 2014 and 2016, it is expected to run a surplus of approximately 2 per cent. During pre-crisis prosperity, the unemployment rate continuously decreased; it was 5.6 per cent in 2008. However, in 2013, it reached 13 per cent. In the coming years, an improvement of 1 to 2 percentage points may be expected.

As described in Part II, Bulgaria was in a deep crisis in the mid-1990s, when the currency board was set up; using the strict monetary policy as an anchor for stability, the currency of the lev was first pegged to the German mark and then to the euro.[13] This monetary system also enforced a disciplined fiscal policy. At the deepest point of the crisis, government deficit was 4.2 per cent, decreasing to 1.2 per cent by 2013. In 1997, public debt was 97.3 per cent and began to decrease steadily as the result of strict fiscal policy and a dynamic increase in GDP, reaching the lowest value in 2008 at 13.3 per cent. When it elevated again, it increased only to 18.3 per cent in 2013 due to the disciplined fiscal policy and the fact that the currency board was maintained. The currency board and the related strict monetary and fiscal policy are considered—by the otherwise divided political class—achievements that are worth keeping. For this reason, Bulgaria did not have to seek international assistance—as Romania did—although there were severe external imbalances.

The regulation of the banking system was in line with the monetary policy. The Bulgarian National Bank imposed measures to strengthen banking supervision, to create reserves and to decelerate credit growth in the decade preceding the crisis. These were also parts of the stand-by agreement concluded with the IMF ending in 2007. As the result of the crisis, it was not possible in Bulgaria to avoid the deterioration of bank assets: the share of NPL was approximately 17 per cent; however, the stability of the banking system was not at risk. Foreign-owned banks continued their deleveraging process, which resulted in a decline in their market share, and at the same time, the share of Bulgarian banks increased from 15.7 per cent in 2008 to 27.3 per cent in 2013 (ECFIN DG 2014b: 17). In June 2014, confidence in Bulgaria's fourth-largest domestic bank was suddenly shaken, resulting in a panic and its closure by the national bank. Depositors could not withdraw funds from the bank for months, and the crisis began to spread to other banks as well. The stabilisation costs of the banking system also contributed to the fact that government deficit and public debt are expected to increase—albeit from a low level—in the coming years (European Commission 2014a).

The pre-crisis economic boom was based on low internal savings and the indebtedness of the private sector, which was concentrated in the

non-financial corporate sector. Corporate debt increased to a high level (124 per cent of GDP in 2010) compared to Bulgaria's EU peers. At the same time, the debt level of the household sector was only 28 per cent (ECFIN DG 2012a: 10). The newly introduced measures concerning the banking system could not prevent the boost of corporate loans because most of loans were in the form of cross-border intra-company lending. Corporate deleveraging is in process, and housing prices have fallen by 40 per cent since 2008 (ECFIN DG 2014b: 15).

In Bulgaria, state-owned companies do not play as important a role as they do in Romania; they remain mainly in the energy and transport sectors. During the crisis, the centre-right government performed large-scale privatisation; however, the centre-left government that came to power in 2013 practically re-nationalised three companies (a chemical company, a weapons producer, and an energy company) after buying stakes in them (Djankov 2014). Public administration has more or less the same weaknesses as in Romania, but the country presents a slightly better absorption capacity: in January 2013 the overall absorption of the seven-year EU funds stood at 26.7 per cent (EC SWD 2013b:3). According to Transparency International's Corruption Perception Index, both Bulgaria and Romania ranked 69th among 177 countries in 2014.

The current account deficit was driven fully by the trade balance of goods, which was financed largely by exceptionally strong FDI inflows before the crisis. A quick correction of earlier deficits took place during the crisis, and the adjustment came on account of reduced imports and the continued growth in exports. Bulgaria's trade activity (in terms of goods and services) relative to GDP is more open than that in Romania or in Croatia but more closed than that in Slovenia and in the smaller Visegrád countries. FDI also plays a crucial role in modernising Bulgaria's economy, but its composition and amounts have been found greatly volatile over time. At the beginning of the 2000s, a notable portion of FDI was absorbed by the manufacturing, transport and communication sectors, mainly by the low value-added, resource-intensive segments within the manufacturing sector (food industry, textile industry, metals, and chemicals). Before the crisis, the flow of FDI shifted towards the real estate and financial intermediation sectors, that is, towards the non-tradable sectors, and the share of the manufacturing sector decreased to approximately

17 per cent. Per capita FDI stock is slightly below the average of the post-socialist EU member states. However, due to Bulgaria's low level of GDP, the total inward FDI stock is approximately 95 per cent of GDP—almost double the average of the above-mentioned countries (ECFIN DG 2012a: 7–8; Hunya 2013: 41, 56).

In spite of the unfavourable composition of FDI, the growth rate of Bulgarian exports is one of the highest among its regional peers (after the decline in 2009), and the global market share of exports increased by 5.7 per cent in the five years leading up to 2013. This process was not hindered by the fact that wage growth before the crisis exceeded the growth of productivity, which manifested in the rise of REER and ULC. Wage growth did not stop after the crisis, but its rate slowed. Wage growth was not fuelled by the wage increase in the public sector, but rather by that in the private sector, which was generated by market processes. However, the baseline level was so low that the non-cost competitiveness factors compensated for the deterioration of cost competitiveness and the increase in ULC was more moderate in the tradable sectors. At the same time, the growth of exports and the growth of Bulgaria's export market share were facilitated by the fact that raw material (basic metals, plastics, rubber, fuels and cereals) prices increased in the 2000s, and after the decline in 2009, prices began to increase again in 2010, which is an uncertain, cyclical component (ECFIN DG 2013b: 19–21). The structural problem is expressed rather well by the fact that while high-tech and medium-level technological products account for almost half of exports in the EU on the average, they account for only one-fourth of the exports in case of Bulgaria. Recently, FDI inflow has tended towards the energy sector, including the renewable energy sources, and there are recent examples of increased investment activity in the automotive, pharmaceutical and metal manufacturing industries (ECFIN DG 2014b: 24), although it would be premature to say that the tide has turned. It is not easy to make changes, and the performance of the Bulgarian innovation system is repeatedly ranked last in the EU scoreboards. During the crisis, expenditures relative to GDP did not decrease, but slightly increased, reaching 0.6 per cent in 2012 (European Commission 2014c: 5, 83).

In Bulgaria, the crisis was most painfully manifested in high levels of unemployment. The unemployment rate increased from 6 per cent to 13

per cent, and the employment rate was 64 per cent—exactly the same as in Romania. In the background of these figures, there are cyclical as well as structural processes. As a result of the decline of the construction sector, the economy significantly shed low-skilled labour, in which it was especially difficult to find employment. The unemployment rate of low-skilled and young workers was equally above 28 per cent in 2012. In spite of national integration programmes, more than half of the Roma people are unemployed as a result of their lower education. The share of the Roma population in the country is estimated at approximately 10 per cent. Bulgarian labour market data are influenced by the presence of the shadow economy, the share of which is similar to the Romanian figure (exceeding it slightly) at approximately 30 per cent of GDP. The government attempted to combat the shadow economy by introducing minimum thresholds for wage and social security contributions, but in doing so, it may limit the employment of unskilled or low-skilled people (Dzhekova and Williams 2014: 15; EC SWD 2013b: 8, 16, 2014a; ECFIN DG 2014b: 32).

Although the labour market position is more favourable for those who are highly qualified, the employment data of graduates show that higher education still cannot respond adequately to labour market demands. The performance of the Bulgarian education system during the crisis is indicated by the fact that Bulgaria was found the worst performer of the EU member states according to the 2012 PISA survey. There were some reform measures aiming to improve quality, especially in higher education and teacher training, but no substantive progress has been made. The quality of vocational education and training also needs to be improved (EC SWD 2014a). Austerity measures during the crisis severely restricted the modernisation possibilities of the education system. Public spending on education was approximately 4 per cent of GDP before the crisis, but even this modest amount decreased to 3.6 per cent in 2011 (EACEA 2013: 7).

Finding a job abroad was a way of channelling labour market tension in the case of Bulgaria. Employees' remittances accounted for approximately 5 per cent of GDP during the years before the crisis—similar to Romania.[14] Bulgaria, with its current population of 7.3 million, lost half a million of its population during a decade, one-third of which (175,000

people) is attributed to international emigration. According to the statistics of the destination countries, the number of short-term or seasonal Bulgarian employees is approximately 300,000–400,000. Return migration has accelerated since the crisis. According to the 2011 national census, almost 200,000 Bulgarians have returned after more than one year abroad since 1980. Most emigration therefore appears to be temporary (OECD 2013h: 238). Unfortunately, this is not enough to save Bulgaria from being one of the most rapidly ageing societies in the EU; moreover, according to the estimations of the United Nations, the population will shrink at one of the highest rates in the world within the next five decades (Onder et al. 2014). Bulgaria's pension system is a three-pillar one, similar to Romania and Croatia. In 2011, the deficit of the pension fund belonging to the first pillar forced the government to gradually elevate the retirement age (65 years for men and 63 years for women) and to abolish certain other allowances (EC SWD 2013b).

The austerity measures that accompanied the crisis affected the pension system and included freezing the wages in the welfare and the public sectors in 2010. Trade unions played a more active part than in Romania in the protests against these austerity measures, although trade union density was low (approximately 20 per cent). Negotiations had been on-going for a long time when, in 2010, an agreement was reached on the very slow, prolonged increase of the retirement age. However, due to the deteriorating budgetary situation, the government brought forward the date of introduction. As a result, two trade unions withdrew from the National Council for Tripartite Cooperation and began organising national demonstrations. Although in 2012, the criteria for social partner organisation representativeness were made more rigorous, the tripartite system remained. The relationship between the trade unions and the government is still heavy with conflicts. Wage negotiations are performed typically at the company level, but the sectoral level remained as well. Collective agreements cover 30 per cent of employees (Eurofound 2014).

In view of the fact that poverty in Bulgaria is even more severe than in Romania, the violent social reactions are more easily understandable. Social inequalities did not increase during the crisis (Table A.8), but the ratio of those who are below the EU's poverty indicator increased from the pre-crisis 44.8 per cent to 48 per cent, and it is even more dramatic that

the ratio for the severely materially deprived accounted for 43 per cent of the population in 2013. Social expenditures and pensions increased slightly in 2013–2014, but the bold growth in public debt questions how sustainable these measures are (EC SWD 2014a). Public trust in politicians is very low—similar to the other CEE countries. In autumn 2014, the national election was won by the conservative Boyko Borisov, whose previous government was toppled by anti-poverty and anti-corruption protests in February 2013,[15] showing that voters cannot find an alternative that provides stability (Table 8.6).

8.4 The Opportunity to Change the Model

Part II highlighted the conclusion that the CEE countries represent a distinct model of capitalism, even though the differences among the countries are significant, which also means that they cannot be identified with the Western European models. As seen, Nölke and Vliegenhart (2009) and Bohle and Greskovits (2012) depict the Visegrád countries as a distinct model. Those who have classified the Baltic countries—or within the Baltic countries, Estonia—(for example, Bohle and Greskovits 2012; Feldmann 2007) often describe them as liberal market economies. However, my empirical analysis makes it clear that the Baltic institutional system does not fit into the model defined as a liberal market economy in the VoC literature. A very important element of the liberal market economy is that capital allocation is performed via the stock market, and its innovation system not only is developed but also downright encourages radical innovations; none of these is present in case of the Baltic states. Furthermore, maintaining general social insurance is not an element of the US-based liberal model, either. In the Baltic countries, within the expenditures of social protection, means-tested benefits account for less than 1 per cent of GDP, which is infinitesimal even if we take the low level of total expenditure into account (EC SWD 2014n: 42, 2014u: 40, 2014f: 38). Among the post-socialist countries, only Slovenia can be considered a borderline case because its institutional system was relatively close to the North-Western model, specifically, to the continental model, before the crisis. According to the classification applied by Schweickert

Table 8.6 Changes in the institutional systems in the South-Eastern European EU member states

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Before 2008						
More moderately liberalised than the other post-socialist countries	Innovation system is weaker than the EU average	Mainly foreign owned and bank-based, except for Slovenia	Less liberalised than the EU average except for Bulgaria, active labour market policy has a meagre role	Trade unions have a moderate role, except for Slovenia	Low level of social protection; large income inequalities, except for Slovenia	Low level of public spending on education; below-average PISA results, except for Slovenia
Characteristic institutional and regulatory features after 2008						
Slovenia						
Constrained, reluctant privatisation	Innovation follower, R&D performance is stronger than the utilisation of R&D in the economy	Domestic-owned banks financed by interbank loans; after restructuring, still significant state intervention; continuous correction of real estate prices	Liberalisation to increase flexibility, and to decrease segmentation	Neo-corporatist institutions are weakening	Pension reform, restriction of social protection intended to be only temporary	Above-average PISA results, mismatch between qualifications and labour market needs
Croatia						

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Constrained, reluctant privatisation; FDI is dominant in the non-tradable sectors; within industry, processing raw materials is dominant	Moderate innovator	Stable, mainly foreign-owned banking system, prudent regulation, continuous correction of real estate prices	Liberalisation to increase flexibility, and to decrease segmentation	Trade union density is strong only in the public sector, company-level wage agreements	Erratic reforms to decrease the fragmentation of the welfare system, restriction of social protection	Below-average PISA results, neither vocational training nor higher education provides an adequately qualified labour force
Romania						
Constrained, reluctant privatisation; composition of exports shifted to more knowledge-intensive products	One of the modest innovators	Within scope of IMF-EU programme, tightening regulations, decreased presence of foreign-owned banks, real estate bubble	Liberalisation to increase flexibility	Trade unions' influence has weakened, company-level wage agreements	Pension reform, restriction of social protection in the course of fiscal consolidation	Below-average PISA results, neither vocational training nor higher education provides an adequately qualified labour force

(*continued*)

Table 8.6 (continued)

Product markets	R&D&I	Financial system	Labour market	Labour relations	Social protection	Education
Bulgaria						
FDI is dominant in the non-tradable sectors, slight shift towards the tradable sectors	One of the modest innovators	Prudent regulation; decreased presence of foreign-owned banks; real estate bubble; after the crisis, unexpected bank panic weakened the financial system	No change in liberalisation	Decentralisation of wage agreements is increasing	Pension reform, restriction of social protection in the course of fiscal consolidation	Below-average PISA results, neither vocational training nor higher education provides an adequately qualified labour force

Source: Author's compilation

et al. (2013), the CEE member states are handled separately, and they constitute two subgroups based on whether the liberal or coordinated market economy is characteristic. It expresses rather well that these countries can be put into a separate group, and within the group, subgroups can be created. However, the terms "liberal" and "coordinated" market economies are misleading. They are the characteristic features not only of the liberal model—see the reference above—but also of the continental model. For example, with the exception of Slovenia, in the other countries, there is no corporative cooperation between employers and employees, which is an essential feature of the model.

The common features shared by all CEE member states are important, especially when the relationship between the self-regulating market and the social forces opposing subordination to market forces is not under investigation—as Bohle and Greskovits do (2012) using a theoretical framework built on Polányi—but rather competitiveness and economic performance. In this case, an important and common feature of the CEE model is the significant role FDI plays in modernisation (the common features of the individual institutional areas have been discussed in 4.6 of Part II). However, it is rather an oversimplification to derive the whole institutional system from only one feature, as in Nölke and Vliegenhart (2009). The lack of capital and management knowledge, adopted European law and weak civil society—all of which are characteristic of the region in question—have had an effect on the evolution of the group of institutions. The important role of FDI was a consequence itself, although its presence undoubtedly affects the formation of institutions to a certain extent. If, however, these countries were not member states of the EU, if civil society were stronger, and if there were more knowledge relevant from the aspect of market economy, the effect of foreign capital on the institutional system would be different, for example, in labour relations or in the innovation system. Furthermore, one of the most serious issues the countries of this region have to face in terms of competitiveness is that foreign corporations have an insular position in the economic environment; thus, their presence cannot explain the institutional system of indigenous economy.

Following the crisis in 2008, the question arises of how the processes of the crisis influenced the CEE model. After the crisis hit the region,

the stability of three Visegrád countries (Poland, the Czech Republic and Slovakia), the dramatic decline in the Baltic states, the serious problems of Hungary and the South-Eastern countries all made the impression that the CEE countries took a different path to development. However, the fast adjustment accomplished by the Baltic countries and the problems of growth in the Czech Republic have indicated that we must be careful and avoid jumping to conclusions too quickly.

The detailed survey of the institutional systems in the individual countries above has shown that the fundamental characteristics of the model remained; in fact, in certain areas (labour market, labour relations, and social protection), convergence occurred among the countries.

It became universally recognised how important the composition of FDI and the preference given to tradable sectors were to those small open economies that (with the exception of Poland) are considered small not only globally but also within the EU. No considerable shift has yet occurred among the individual subgroups; the Visegrád countries and Slovenia are still characterised by the fact that FDI is centred on the tradable sectors, especially in the manufacturing sector (and Romania also shows favourable data). Owing to the crisis, it has become necessary to initiate privatisation in all those countries in which there are still state-owned companies to notable degree and where the budget is in need of revenue. This process is advancing very slowly and reluctantly in Poland, Slovenia and Romania because these governments are rather unwilling to give up their remaining state-owned companies. Only Hungary has chosen a different path: the government is expanding the sphere of state-owned corporations.

No breakthrough has occurred in any of the countries in the institutional system of R&D&I, and according to the scoreboard of the EU, there have not been significant changes in their position in comparison to either the OMS or to each other. Among the countries less affected by the austerity measures, in the Czech Republic the increasing input has not yet had a tangible effect on the performance of the innovation system, and Poland, which escaped the recession, could not make use of its advantageous position.

The financial system remained bank based,[16] and foreign owners retained stability. In Latvia and Slovenia, the restructuring of domestic-

owned banks weighed heavily on the budget. As for the future, there is an on-going rearrangement within the region, in line with economic prospects; in the riskier countries, parent banks are decreasing their exposure. Hungary is again moving along on a different path. In Hungary, foreign banks are struck heavily by surtaxes and the cost of foreign currency mortgage relief schemes; at the same time, the state is strengthening the positions of state-owned financial institutions by purchasing foreign banks and reorganising savings cooperatives.

All countries continued to carry out liberalisation or preserved the already strongly liberalised regulation in the labour market as a reaction to the problems of employment. As far as labour relations are concerned, the role of the trade unions continued to weaken, or in certain cases, it remained unchanged. In light of their historical background, it is hardly surprising that none of the countries considered sharing the burden of the crisis between employers and employees on the basis of the agreement among the social partners. The protests, if there were any, were directed against the governments in question because the austerity measures reached the people primarily through the budget: either as public servants or via curtailing social services.

Social protection has become weaker not only because of the temporary measures of budgetary consolidation but also because pension systems were changed due to the increasing costs caused by ageing. The second pillar of the pension system was either cut off in many countries or nationalised entirely in order to fill the holes in the budget. The difference in social protection among the countries is showing a decreasing tendency. According to the most recent data available (2012), expenditures as a percentage of GDP were 14–16.5 per cent in the Baltic countries and Romania, 17–19 per cent in Bulgaria, Poland, and Slovakia, 20–22 per cent in the Czech Republic, Croatia, and Hungary, and 25.4 per cent in Slovenia. (In the meantime, the EU average was 29.5 per cent.)

Overall, it can be said that the characteristic features of the model remained: modernisation is built on FDI, the innovation system is weak, sustaining competitiveness is possible only by a liberalised labour market and low social expenditures, and employees are vulnerable.[17] In the unfavourable global economic situation, the pace of growth is slower,

but in this region—unlike in the Mediterranean countries—convergence continues in the majority of the countries.

The positive effect of EU membership on the functionality of the model can be observed clearly if we compare Romania and Bulgaria (both have a definitely more unfavourable historical legacy than that of the Visegrád countries) with countries whose attributes were similar at the beginning of the socio-economic transformation: the former with Moldova and the latter with Macedonia. In the institutional change, the non-EU countries gradually fell behind the EU member states, and these processes show that the EU conditionality acts as an anchor (Ahrens and Zweynert 2012). The differences between the EU member states, the acceding countries and the other post-socialist countries concerning the institutional system of the market economy appear even more spectacularly in EBRD's Transition Report of 2013 (EBRD 2013: 109).

Nevertheless, with time, the limitations of the model become increasingly visible. The difficulties of growth in the case of the Czech Republic have been discussed in detail above. In Hungary, the economic transition was not accompanied by such a political success as the birth of the sovereign nation state; as it happened in several countries, at the same time, the "Goulash communism" of Kádár's regime focused attention on the material well-being to a greater extent than any other country. Because the new system was not similar to, for instance, the most coveted social market economy of the neighbouring Austria, the resulting disappointment and discontentedness led to the questioning of the model, and the system change is generally regarded as a failure. The Orbán government has been experimenting with the introduction of a new model since 2010, in which the state and indigenous capital have a major role. In the Baltic countries, emigration acts as a safety valve and canalises discontent instead of creating internal political conflicts.

During the crisis, a change of approach took place in the EU and OECD analyses, contrary to the views described in 2.7 of Part II. Recently, the authors of these analyses considered that the convergence potential of the model is limited if the export capacity of the companies in the CEE countries is closer to the lower end of the value chain. The criteria for persistent convergence are to move upwards in the global value chain, to

strengthen the indigenous growth drivers, to improve the quality of the institutions and to develop education and the innovation system.

Nevertheless, the restructuring of the institutional system has brought up serious dilemmas, as in the Mediterranean countries. The duality of the FDI impact has already been discussed in 4.7 of Part II, that is, it undoubtedly had a modernisation effect on these economies, but the spillover effect has been more limited than expected at the time of the transition or compared to the impact hypothesised on the basis of economic theory.[18] By the turn of the century, the state's endeavour to attract FDI through targeted economic policy had become widely accepted in the CEE countries (Drahokoupil 2009). First, it was characteristic of the Visegrád countries and Slovenia to apply various incentives to direct foreign investments towards the tradable sectors, especially manufacturing; currently, the FDI policy of, for example, Estonia, Romania, or Croatia also strives to find investments in the sectors with high technological levels (Kostevc et al. 2011). In Hungary, as early as 2000, the government consciously tried to connect the multinational companies and the domestic SME sector and to eliminate the dual structure of the economy by launching the "Széchenyi plan". The subsidies granted to companies not for the purpose of crisis management have considerably exceeded the EU average relative to GDP (between 2004 and 2011, it was 2.7 times the EU average) ever since, regardless of the political composition of the government in power. However, both the performance of the economy and the survival of the dual structure show that the subsidies did not achieve their objectives. The unstable regulatory environment, the high market share of the enterprises under the control of the central and local governments and the disincentive effect of the allowances granted to the smaller companies—among others—are all responsible for this failure (Kállay 2014: 284, 291–296). Slovakia, which did not apply active industrial policy as Hungary did (Duman and Kureková 2012), shows far better results in economic growth and in catching up with the EU average (Table 4.2). Again, we may come to the same conclusion as we did in relation to the Mediterranean countries: it is not enough to recognise the problem and to select a device that, in itself, seems relevant and appropriate to tackle the problem because, without creating a suitable institutional environment, the device in question remains ineffective.

The consistently applied Slovakian neoliberal economic policy has been more successful than the Hungarian economic policy, which employed an inefficient development policy.

As a result of the crisis, it has become clear that Slovenia cannot continue the separate path it had taken. It shows that, for the other countries, there is no alternative to combining modernisation built on FDI with the development of the indigenous economy and to the related Sisyphean institution building. It is exactly this recognition that prevents us from entertaining the hope that the Hungarian attempt will succeed, that aims to accelerate economic growth by increasing state ownership and creating regulations that intervene deeply in market processes.

The "firm-centred" approach of Hall and Soskice (2001)—as elaborated in detail in 2.4 of Part I—has been criticised from the start because it did not take the role of the state into consideration when creating the model; soon after, it was corrected in VoC literature. The analyses of both the Mediterranean and the CEE countries have shown that the state has a fundamental role not only in running the social services system and the educational system but also directly in the performance of the economic system. Therefore, the corrections made so far are not sufficient.[19] The operation method of the state must be integrated more organically into the models because the professionalism of regulation, the level of corruption and other elements of good governance fundamentally affect and influence the operation and the competitiveness of the institutional system of economy.

Theoretically, there is a way to produce a gradual and systematic transformation of the CEE model into an institutional system in which the value-producing ability of domestic economy increases. This would make it possible to converge to a (more) social market economy, but it would be difficult to predict its relatedness to Western European institutional systems due to its lack of corporatist traditions. In the case of the three countries (Poland, the Czech Republic, and Slovakia) that pulled through the crisis relatively well, their success was due to their favourable composition of FDI and their geographic position (these countries are integrated into the German supply chain), and stable public finance[20] prevented them from accumulating a substantial imbalance prior to the crisis and made them more resistant to external shocks. However, as far as

the critical issue of the CEE model is concerned (that is, that indigenous companies should ascend in the global value chain), these countries could not reach a turning point. The question remains open: which country is able to establish a group of institutions that will achieve a breakthrough?

Notes

1. It is difficult to obtain a clear picture of the debt of the private sector because, according to Eurostat data (accessed on 14 August 2014), consolidated debt decreased from approximately 80 per cent in 2009 to 60 per cent in 2012. According to Eurostat data (accessed on 9 January 2015), it decreased from 287 per cent to approximately 207 per cent.
2. http://ec.europa.eu/economy_finance/events/2014/20140221-drivers_of_growth/index_en.htm, date accessed 05 January 2015.
3. http://www.imd.org/news/2014-World-Competitiveness.cfm, date accessed 05 January 2015.
4. No precise data can be obtained about the exact size of the Roma population. The self-declaration of the national censuses shows only a fragment of the actual population. The number of this population is estimated to be between 150,000 and 300,000, which means 2–3 per cent of the population.http://ec.europa.eu/justice/discrimination/files/roma_country_factsheets_2013/czech_republic_en.pdf, http://www.visegrad.info/minorities-social-exclusion-roma-minority/factsheet/roma-minority-in-visegrad-countries.html, date accessed 05 January 2015.
5. Directly after the Socialist-Liberal coalition won in 2006, in autumn, at a meeting with the Socialist parliamentary fraction Prime Minister, Ferenc Gyurcsány, admitted that he had lied during the campaign, failed to govern adequately, and manipulated the statistical data in order to win re-election. His speech was recorded, and the tape was leaked, which was followed by a series of protests (Tóth et al. 2012). Gyurcsány clung to office until 2009, a year after an opposition-called "social referendum" was held in which a large majority voted to repeal fees for university tuition and doctor and hospital visits in 2008.
6. http://kozfoglalkoztatas.kormany.hu/a-kozfoglalkoztatas-fobb-statisztikai-adatainak-idosora-2013-tol-havonta, date accessed 10 June 2015.
7. See Csaba (2013) about the controversial results of the Hungarian transition and the "derailment" after the EU accession.

8. As opposed to data indicated by ECFIN DG (2014m: 22), EC SWD (2014z: 46) data from 2009 and 2013 are 150.8 and 131.4 per cent, respectively.
9. http://www.euractiv.com/sections/elections/political-novice-wins-slovenia-election-303448, date accessed 05 January 2015.
10. In connection with Croatia, the referenced literature has never failed to emphasise the development of "crony capitalism" in relation to privatisation. It must be noted that before the crisis, according to the findings of the WEF competitiveness report in 2008–2009 (Schwab and Porter 2008:369), in the case of the "Favouritism in decisions of government officials" indicator, Slovenia took the 62nd, Croatia the 86th, Poland the 105th, Czech Republic the 110th, Bulgaria the 111th, Hungary the 112th, Romania the 113th, and Slovakia the 116th ranks. In the report for 2013–2014 (Schwab 2013: 416), Poland took the 65th, Croatia the 112th, Slovenia the 114th, Hungary the 116th, Bulgaria the 117th, Czech Republic the 123rd, Romania the 137th, and Slovakia the 144th ranks. Because these data originate from interviews with company managers, which are considered soft data, we must interpret them with caution. Nevertheless, it is clear that Croatia's position in building clientele is not as blatant if we compare it with the Visegrád countries.
11. According to the 2012 census, the number of people who were abroad for more than a year was 727,540, but the Romanian statistics office itself finds this figure an underestimation. In 2011, 800,000 Romanian people were registered in Spain and almost one million in Italy (Mereuta 2013: 129–130). According to the Migration Outlook published by the OECD, the number of Romanians working abroad was 3.5 million, in contrast to the estimation (2.5–2.7 million) made in 2010 (OECD 2010j: 236, 2013h: 288).
12. Data for 2008 are missing from the European Commission's series (EC SWD 2013f: 42); EC SWD (2014h: 50) indicates that public spending on education was 3.1 per cent in 2011.
13. Bulgaria followed the same path it had taken in the inter-war period, when huge reparations (imposed after WWI) were added to high public debt and Bulgaria, in order to be able to handle the situation, insisted on returning to pre-war gold standard rules, pursuing strict fiscal policy, and meeting the external payment obligations; as a result, it never went bankrupt. Romania was on the winning side in the war, received reparations, pursued a protectionist policy and was active in using monetary and fiscal policy—nevertheless, it defaulted in 1933 (Nenovsky et al. 2011).

14. Source of data: http://www.unece.org/fileadmin/DAM/oes/disc_papers/ECE_DP_2008-5.pdf, date accessed 12 December 2014.
15. http://www.economist.com/blogs/easternapproaches/2014/10/bulgarias-election, date accessed 12 December 2014.
16. For details on the operation of the financial markets during the crisis in Central-East Europe, see the analysis by Kiss and Kosztopulosz (2013).
17. An analysis of the inequalities of the post-socialist and the old Central European member states in terms of competitiveness on the regional level is provided by Lengyel and Rechnitzer (2013).
18. For more recent Eastern European or Hungarian examples, see Sass (2011), Franco and Kozovska (2011), Antalóczy et al. (2011).
19. This statement also confirms Szanyi's (2013) remark made in connection with the "crony capitalism" often mentioned in relation to the CEE countries.
20. For details on the development of institutions pursuing disciplined fiscal policy in response to the CEE crisis, see Kovács (2014).

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Part IV

European Integration of the Varieties of Capitalism

With the help of the in-depth analyses in Part III, the driving factors of the crisis in the 28 EU member states, how the various countries reacted to the crisis in terms of institutional changes and the extent to which it has altered the models of capitalism have been described. In this Part, I attempt to identify, by applying quantitative means, the groups of countries showing similar features on the basis of the characteristics that proved to be fundamental from the perspective of the driving factors of the crisis. Then, all conclusions drawn from the analyses so far are summarised. Finally, an overview of the consequences these findings entail with regard to the European integration is provided.

9

Classification Based on the Driving Factors of the Crisis and the Models of Capitalism

The severity of the crisis in the various countries is most frequently measured in the GDP growth rate or as the evolution of per capita GDP. However, the cumulative impact of the crisis is expressed most graphically by how the cumulative value of GDP volume changed during the five-year period after the beginning of the crisis, compared to the GDP for 2008. The impact on households is more expressively shown by private final consumption data, which are worth measuring in the same way. The latter have also been influenced by the speed of adaptation to the effects of the crisis (Table 9.1).

I attempted to estimate the relationship between the cumulative losses or gains of GDP and the driving factors of the crisis using a regression analysis. As described in detail in Part III, the driving factors of the crisis appeared in various combinations in the individual countries; thus, it is hardly surprising that the regression analysis did not lead to useful results. Therefore, I apply a cluster analysis, which provides interpretable results. From the aspect of the driving factors of the crisis—on the basis of what has been described in the previous Part—besides GDP losses, the following issues were very significant: the size of the current account deficit when the crisis started, the level of indebtedness in the private and the

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Table 9.1 Cumulative losses/gains of GDP and private final consumption between 2009 and 2013 as a share of 2008 GDP

Cumulative losses/gains of GDP (2009–2013) compared to 2008, at constant prices, as a share of 2008 GDP			Cumulative losses/gains of private final consumption (2009–2013) compared to 2008, at constant prices, as a share of 2008 private final consumption		
1	Poland	0.44	1	Poland	0.35
2	Sweden	0.12	2	Sweden	0.25
3	Malta	0.10	3	Austria	0.16
4	Slovakia	0.06	4	Belgium	0.15
5	Germany	0.01	5	Germany	0.15
6	Belgium	0.00	6	Luxembourg	0.14
7	Austria	–0.02	7	Malta	0.10
8	France	–0.03	8	France	0.09
9	Luxembourg	–0.09	9	Finland	0.06
10	Czech Republic	–0.11	10	Czech Republic	0.02
11	Cyprus	–0.13	11	Slovakia	–0.04
12	Netherlands	–0.13	12	Slovenia	–0.05
13	UK	–0.14	13	UK	–0.10
14	Portugal	–0.18	14	Italy	–0.13
15	Bulgaria	–0.19	15	Denmark	–0.15
16	Denmark	–0.20	16	Netherlands	–0.17
17	Spain	–0.24	17	Portugal	–0.24
18	Finland	–0.26	18	Bulgaria	–0.28
19	Italy	–0.26	19	Spain	–0.29
20	Romania	–0.26	20	Ireland	–0.31
21	Hungary	–0.28	21	Cyprus	–0.37
22	Estonia	–0.28	22	Romania	–0.44
23	Ireland	–0.30	23	Hungary	–0.46
24	Slovenia	–0.39	24	Croatia	–0.47
25	Lithuania	–0.43	25	Estonia	–0.61
26	Croatia	–0.48	26	Greece	–0.74
27	Latvia	–0.67	27	Lithuania	–0.79
28	Greece	–0.69	28	Latvia	–0.80

Source: Author's own calculation based on the AMECO database

public sectors, the size and vulnerability of the banking sector, whether there was a housing bubble, the openness of the economy in the export and import of goods and services, the size of inward FDI stocks as a percentage of GDP, the percentage of the gross value added of industry and financial services, what productivity was like, and how the REER evolved (Table A.10). Through a hierarchical cluster analysis using Ward's

variance method, the relationships among the countries and the groups of countries can be plastically represented in a dendrogram (Fig. 9.1).[1]

I have chosen the division into six from among the potential clusters because of its economic explanatory power. Two countries—Luxembourg and Ireland—constitute individual, "single-member" clusters on their own due to their outlier values, and besides these clusters, the CEE member states and the others separate themselves in the first step. Leaving the analysis like this would provide us with a very superficial picture.

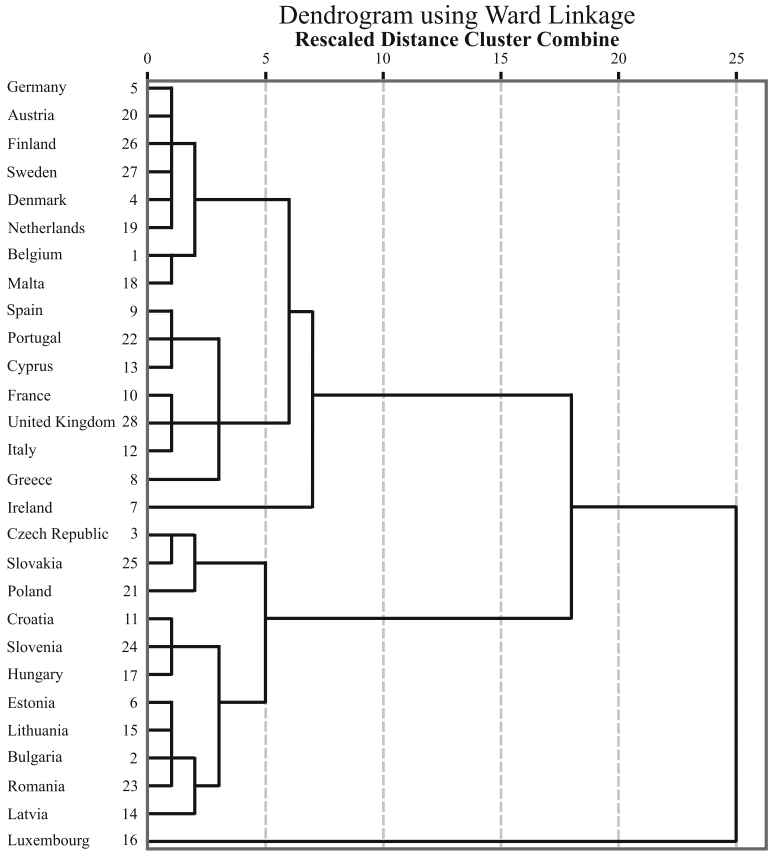

Fig. 9.1 Classification of the EU member states according to the driving factors of the crisis in 2008, using hierarchical cluster analysis. *Source*: Author's own calculations

However, including more than six clusters would split the groups excessively because of the small number of elements.

The first cluster can be named "*Stable North-Western Europe*", and Malta joins this cluster from the Mediterranean countries as a result of its stable financial system and small GDP losses. It is characteristic of this cluster that GDP losses are slightly below average, and with the exception of Denmark and Finland, the countries had a positive current account and their amount of private debt was above average (except for Germany) when the crisis hit them. The value added of industry as a percentage of GDP is slightly above average, while that of business and financial services is average. Their labour productivity—with the exception of the two outstanding clusters—is the highest. Their banking system was extended relative to the GDP when the crisis started, but during the crisis, the banking system remained stable, the restructuring costs were below average, there was no housing bubble, and if there was price adjustment, it was continuous and balanced.

The second cluster has been described as "*Unstable Mediterranean*", with France and the UK wedged in as well. These countries had above-average GDP losses and current account deficit and the largest amount of debt in the private sector—with the exception of the two outstanding clusters—when the crisis began. Between 2008 and 2011, the decline in the real estate market was not as dramatic as in case of the cluster of the Estern and South-Eastern countries. However, this was attributable to the fact that in the Mediterranean countries, the crisis escalated later than in the previously mentioned cluster. Public debt in 2008 was the highest in this cluster, but the standard deviation exceeded that of the EU-28. In this cluster, the inward FDI as a percentage of GDP is the lowest, the added value of industry is the lowest, but the added value of services is above average, while productivity is slightly above average. The relatively large banking sector carried above-average restructuring costs. Although France had below-average GDP losses and low bank restructuring costs, it is not in the first cluster because its economy is less open and because the industry's share in GDP is small. The GDP losses of the UK are about average, but its cost of bank restructuring is above average and—similar to France—the industry's share in the GDP is small; therefore, the UK cannot be placed in the first cluster.

The third cluster is related to the OMS and contains only Ireland, bearing the name "*Victim of the banking system*". The country's indicators in 2008 show smaller imbalances, but nevertheless, it would fit into the countries of "Stable North-Western Europe"; however, the collapse of the real estate market and the crash of the banking sector, not to mention its huge restructuring costs, make Ireland an outstanding case.

The fourth cluster, "*Stable East Central Europe*", contains the Czech Republic, Slovakia, and Poland. The cluster average of GDP shows gains, and as seen in Table 9.1, even "the weakest link", the Czech Republic, has below-average losses. The difference between these countries and the other countries in the region can be found in these countries' better indicators of external and internal balance in 2008 and in their strong industrial performance. In the EU, these countries had the smallest banking sectors relative to GDP, and they did not spend money on them. Their balance could not even be disturbed by the fact that during the three years before the crisis, the appreciation of the REER was the greatest because it took place on a low level.

The fifth cluster, "*Unstable Eastern and South-Eastern Europe*", contains the remaining countries of the region: Estonia, Latvia, Lithuania, Hungary, Slovenia, Croatia, Bulgaria, and Romania. This group of countries suffered the greatest GDP losses during the crisis and the greatest drop in real estate prices—apart from Ireland. The presence of FDI is approximately the same size as in the previous cluster, but the performance of industry is less significant and services have a greater role in trade. Labour productivity is the lowest in this cluster. The relatively small banking system in this cluster caused minimal restructuring costs. At the same time, we must note here that the Slovenian restructuring costs soared in 2013; however, these data were not included in the most recently available EU data source. Although Hungary's real economic features are similar to those of the previous cluster, Hungary is included in this cluster because its financial imbalance had already accumulated before the crisis.

The sixth cluster is Luxembourg, the "*Lucky offshore financial haven*", with all its indicators reflecting that the services are dominant both in the structure of economy and in foreign trade. Although the amount of private debt was high and the financial sector was huge when the crisis

hit the country, it pulled through the five years that followed 2008 with below-average GDP losses and with restructuring costs just slightly above the average.

The amount of GDP losses the countries accumulated during the crisis did not follow the grouping of the countries according to capitalist models. If we take into account the 2008 indicators considered relevant in terms of the driving factors of the crisis, the resulting groups of countries are more similar to the models of capitalism identified on the basis of institutional characteristics. The Nordic and the North-Western countries are mingled, but the Mediterranean countries remained in one cluster—with the above-described inclusion of France and the UK. The Eastern and Central Eastern countries constitute one group, as seen on the dendrogram, and the subgroups are within themselves. The differences between the two categorisations draw attention to two correlations.

On the one hand, it can be seen that the size of the economy matters because it can determine the country's vulnerability. Denmark has favourable institutional features characteristic of the Nordic countries, and only the amount of private debt was high among the crisis parameters; nevertheless, it suffered substantial losses. In the case of Finland—which experienced a minor decline, but it is invariably on top of the international competitiveness ranking—losing the pull factor of Nokia and the difficulties of the electronics sector were enough to account for losses that were similar in size to those of the Spanish and Italian economies. At the same time, France, which struggled with problems in terms of competitiveness, was able to decrease its losses due to its huge internal market. The first place of Poland in the ranking of gains and losses also confirms the beneficial effect of the greater internal market. In the case of the smaller countries—as we have seen, in Luxembourg, Cyprus, and Malta—one single factor, the different regulation of the financial sector, landed them in very different situations.

On the other hand, the economic structure and the size of the tradable sectors—especially where, due to its size, a country was more open—had a role in determining vulnerability during the crisis. The main beneficiaries of the relatively greater tradable sector were those Central European countries that were built on the German economy—which was capable

of growing outside Europe. Overall, the more balanced distribution of the industrial and service activities has alleviated vulnerability.

Finally, it is noteworthy that the characteristics of the driving factors of the crisis did not determine the long-term development prospects of the economies; for example, in "Unstable Eastern and South-Eastern Europe", the Baltic countries are showing quick and dynamic adaptation, while the improvement of the others is much slower.

Note

1. Hair et al. (1998) provide a detailed description on the methods of cluster analysis.

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10

Lessons to Learn from the Institutional Analysis

In the previous part, the models of capitalism are constructed in terms of the member states of the EU on the basis of empirical analysis, and an overview of the institutional changes that occurred during the crisis in 2008 is given. Now, it is time to summarise the lessons worth learning and to draw conclusions that have relevance, on the one hand, to the comparative studies on the institutional systems and, on the other hand, to the overall European integration.

The *most important message* this study conveys is that all EU member states can be analysed within a single theoretical framework. There is no theoretically well-grounded reason why the post-socialist member states should be treated separately from the others. As it demonstrated by the empirical analysis in Part II, on the one hand, these countries constitute a new, distinct model, and, on the other hand, this model can be compared to the other models within one classification system. This finding is confirmed by the above-referenced Transition Report of EBRD (2013) and the study made by the IMF on the 25 years of transition (2014). The report made by the EBRD measures the extent to which economic institutions are able to meet the international standards of an industrialised market economy. The IMF study (2014) shows a cluster analysis based on

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a few indicators on the basis of data from 1998–2000 and on data from 2011–2013. Both studies have revealed that the member states of the EU broke away from the other post-socialist countries and that, on the basis of their institutional systems, they belong to the fully functioning market economies. Furthermore, from the detailed assessment performed by EBRD, it can be seen that the countries with the prospect of EU membership were also able to enact deeper changes. It is especially important to emphasise this because the unsolved theoretical problems of the traditional, divided VoC literature, which studies the developed and post-socialist countries separately, may promote invariable categorisations and comparisons of the post-socialist economies. Drahokoupil and Myant (2015) make a distinction between the countries of the post-socialist region on the basis of the ways they integrated into the global economy. They also add that this is not a comprehensive theoretical framework; they aim to account for these countries' different economic performance. Whether desired or not, these authors maintain the conception that CEE member states still constitute a "separate world" within the EU.

This separation cannot be sustained because of the differentiation of the post-socialist region and because, during the crisis, it became evident that there are at least as deep institutional differences between the North-Western and the Mediterranean countries as between the North-Western and the CEE countries. The institutional deficiencies of the Mediterranean countries remained hidden by a favourable period of economic growth that coincided with the introduction of the euro. The category of the "mixed market economy", which was, according to the dual categorisation of Hall and Soskice, considered the category for the Mediterranean countries, has never been a subject of thorough scrutiny in VoC literature, which also contributed to the fact that this issue has not been brought into the limelight yet.

In order to be able to interpret the economic performance of the various groups of institutions and to assess their long-term prospects in terms of competitiveness, the role of the state must be integrated not only because of the CEE countries but also because of the Mediterranean countries. As seen in Chap. 2, Soskice (2007) finds it necessary to relate the welfare functions of the state to the investigation of the production systems. The development of both the Mediterranean and CEE countries

has shown clearly that this solution is not sufficient. The regulatory functions of the state and the quality of the business environment—which is determined by these functions—contribute to the differences among the models to an extent that cannot be ignored.[1] I remove those indicators from the WEF GCI that pertain to the professional, effective, fair, and transparent legislative and regulatory activity of the state or public administration. These indicators are all soft data without exception,[2] but—in spite of this limitation—it can definitely be seen that different states or public administrations with different quality functioning relate to the different models of capitalism (Table 10.1). The difference between the Nordic and North-Western groups of countries is small (even if the English-speaking countries were treated separately, it would not change the picture), and similarly, the average of the rankings of the Southern European and the CEE groups of countries is similar. Even the two island countries—formerly under British rule—perform significantly better than the larger Mediterranean countries. Estonia, with its high rankings, has been excluded from the average of the CEE countries because it biases the group average.

The divide is striking between the Nordic, North-Western countries and the Southern, CEE countries regarding the quality of the state's economic regulation. The gap is also markedly evident in how developed the innovation systems are (Fig. 3.2). During the crisis, a divergence could be observed explicitly in the performance of the innovation systems, and it only in 2014 did the innovation report give an account of the halt and the reversal of divergence (European Commission 2014c). Pelle and Végh (2014) choose indicators from the WEF GCI that express the R&D&I readiness of the innovation system and carry out a cluster analysis confirming the existence of the divide between the Nordic, North-Western countries and the Southern, CEE countries.[3]

Another common feature of the Southern and the CEE countries is that both regions have to rely on foreign capital for modernisation. The difference between the two regions is that, in the CEE countries, the most important form of foreign capital was FDI, and foreign capital flowed in the Mediterranean countries in portfolios and other forms, as described in Chap. 4. Both regions have experienced the substantial efficiency gap between the operations of enterprises taking part in foreign trade and

Table 10.1 Ranking of the EU member states in terms of efficient, transparent, and fair functioning of the state based on the ranking of the GCI

	Diversion of public funds	Public trust in politicians	Irregular payments and bribes	Favouritism of government officials	Wastefulness of government spending	Burden of government regulation	Efficiency of legal framework in settling disputes	Transparency of policymaking	Average of rankings
Sweden	15	11	20	9	10	20	13	13	14
Finland	3	5	2	4	9	7	2	3	4
Denmark	2	16	13	13	36	80	20	32	26
Average of the Nordic countries' rankings									**15**
United Kingdom	11	19	15	17	33	37	5	16	18
Ireland	12	22	9	15	31	22	21		16
Germany	18	15	25	12	20	55	11	22	22
France	27	42	30	30	72	121	41	70	54
Netherland	11	9	14	6	18	30	9	14	14
Belgium	16	23	19	24	59	130	42	56	46
Luxembourg	5	7	6	11	16	9	12	6	8
Austria	31	36	26	28	53	83	24	21	38
Average of the North-Western countries' rankings									**27**
Italy	93	139	74	135	139	142	143	143	126
Spain	90	117	50	78	113	123	90	105	96
Portugal	41	67	32	54	88	108	111	81	73
Greece	81	106	78	109	131	136	126	120	111
Cyprus	37	58	34	63	56	15	51	25	42
Malta	40	43	59	72	34	76	37	65	53
Average of the 4 large Mediterranean countries' rankings									**101**
Average of all Mediterranean countries' rankings									**83**
Estonia	28	38	18	23	19	10	39	20	24

	Diversion of public funds	Public trust in politicians	Irregular payments and bribes	Favouritism of government officials	Wastefulness of government spending	Burden of government regulation	Efficiency of legal framework in settling disputes	Transparency of policymaking	Average of rankings
Latvia	68	84	41	70	79	75	116	43	72
Lithuania	66	83	47	62	90	105	84	28	71
Poland	50	101	43	67	85	117	118	110	86
Czech Republic	98	138	70	106	7	132	100	99	81
Slovakia	130	121	100	141	126	137	137	74	121
Hungary	110	113	56	122	96	129	104	119	106
Slovenia	79	133	42	111	133	133	131	55	102
Croatia	64	124	67	119	129	141	134	121	112
Romania	82	109	68	114	116	94	106	86	97
Bulgaria	118	130	55	134	98	102	124	124	111
Average of the CEE countries' rankings without Estonia (with Estonia 89)									**96**

Source: Author's compilation by Schwab (2014)

those not taking part in foreign trade, between the multinational companies and the SME sector, which indicates the problem of economic duality. Szerb et al. (2013) formulate the Regional Entrepreneurship and Development Index, which assesses the entrepreneurial attitudes and their regional and institutional contexts. The European Commission used this index in their 6th Cohesion Report. The separate positions of the Nordic and North-Western countries can be observed here as well. If only individual attitudes are taken into account, the Mediterranean countries show a more favourable picture.[4]

It follows from the above that the similar features shared by the Mediterranean and CEE countries can be observed precisely in those areas (innovation system, the quality of the regulation of the business environment, the structure of the corporate sector, and the level of development of the SME sector) of utmost importance from the viewpoint of competitiveness and long-term economic growth. Consequently, *the second important lesson to learn from this study is that the comparison of OMS and NMS has become out-dated*, as deeper institutional differences can be revealed between the Nordic, North-Western (English-speaking and continental) countries and the Southern (Mediterranean), CEE countries than in the former division.

Further investigation may reveal a number of underlying long-term cultural and political factors (the role of corruption, the relationship between citizen and state, the strength of public institutions, rule of law, social dialogue, and so on) that have an important impact on North-Western and South-Eastern division and on the prospects of economic convergence, but this investigation goes beyond the scope of this study.

Soon after the crises in 1929–1933 and in 1973, economic policy changes were accompanied and/or followed by a new economic paradigm. We have not seen a similar change since the 2008 global crisis; the short-lived budgetary incentives in 2009 and monetary easing do not add up to a Keynesian renaissance, for example. The changes in economic policy on the product and labour market—or, at least, their intentions—all point in the direction of liberalisation. Strengthening competition in the network industries is continuously on the agenda throughout the EU (therefore, it was not even mentioned when the countries were described individually). Only those cases in which there is a conspicuous difference

in the intensity of competition between the tradable and non-tradable sectors (in certain Nordic, continental, and Mediterranean countries) have been noted. In countries where there is considerable amount of state property to be privatised (some post-socialist countries, Greece, and Cyprus), privatisation is occurring, albeit quite reluctantly. Only Hungary is trying to reverse this process, increasing state property in the banking sector, primarily in the energy sector and in other public utility services.

The problems of the financial system have shown that both extreme deregulation and politically influenced state ownership are able to undermine the stability of banks. The crisis in 2008 confirms that market competition and strong state regulation are not incongruous—on the contrary, they are interdependent.

Labour market liberalisation is another common tendency. Wherever changes were implemented during the years of the crisis, the main objective was to increase the flexibility of the labour market. The segmented labour market and the fact that different employment protection was applied for employees with open-ended and fixed-term contracts called for reforms, primarily in the Mediterranean, the continental, and some of the CEE countries. As a result of the crisis, in response to increasing unemployment, in educational systems across Europe, attention was focused on meeting the demands of the labour market and on vocational education; the introduction or the strengthening of the dual training was generally accepted as the only solution.

In the field of labour relations, the reduction of trade union density continued during the crisis throughout the EU, and a general tendency was the decentralisation of collective wage negotiations towards the corporate level. Nevertheless, social partnership is still invariably strong in the Nordic and—with the exception of the UK and France—in the North-Western countries. In the Mediterranean countries, cooperation between employers and employees remained problematic, burdened heavily by conflicts, except in the two small island countries. Because, with the exception of Italy, restructuring—as a result of the crisis—took place with external help, it was no question that, ultimately, trade unions had to give in. The programmes of economic and social policy were not based on social consensus in any case—if there had been consensus, a new

chapter would probably have been opened in social partnership. Thus, it seems conceivable that the economic constraints will bring the role of the trade unions closer to those of the CEE countries in the long run. In the CEE countries, labour relations have remained similar to those before the crisis; that is, employees are vulnerable and trade unions are weak, and in the South-Eastern European countries, where trade unions previously showed greater activity, the reduction of trade union density has made them more similar to the Visegrád countries.

Common features can also be found in social protection during the crisis; on the one hand, budgetary consolidation led more or less to austerity measures in welfare provision, and, on the other hand, due to the ageing of society, pension systems were affected throughout Europe. The position of the groups of countries and the models relative to one another has not changed much in terms of social protection. In case of the expenditures on social protection, GDP—the reference value for comparison—has shrunk, increasing in relative proportion in the Mediterranean countries: between 26–31 per cent of GDP in the four larger Mediterranean countries in 2012. Due to the large proportion of pensions, their slow changeability and the consequences of unemployment, these expenditures cannot be decreased easily in the short term. It cannot be predicted whether, in the long run, the Mediterranean countries will be able to preserve their position, which makes them more similar to the Nordic and North-Western countries than to the CEE countries in terms of the development level of the systems of social protection. As the crisis nears its end, the CEE countries have begun to return to the pre-crisis proportions in their social expenditures; that is, they are lagging far behind the OMS and constitute two subgroups. One subgroup consists of the Baltic countries and Romania, which spend at the level of GDP, that is, half of the EU average, while Bulgaria, the Visegrád countries, Croatia, and Slovenia constitute the other subgroup, spending a few percentage points more. This is the only field in which there is a divide between the OMS and NMS.

The individual fields of social protection have not been scrutinised in detail because it would be well outside the scope of this book, although the contribution of the quality of, for example, the health care system to competitiveness is hardly disputable. In two cases, the Netherlands and

Slovakia, unsuccessful marketisation attempts have already been mentioned, providing very important lessons in terms of these institutions. On the one hand, the introduction of marketisation can be successful only if it takes place in each element of the system in question. On the other hand, it would be a mistake to assume that there is a solution that does not use the substantial proportion of revenues when we want to maintain the relatively (for example, compared to the USA) low level of social inequality.

During the crisis, the factor that has influenced the development of the individual countries since the 1990s was given special emphasis. It is equally true for France, Italy, Hungary, Greece, and Slovenia that economically unrealistic expectations and an unrealistic overview of the situation widely distributed throughout society (continually strengthened by part or the whole of the political elite) stand in the background of their poor economic performance (which persistently lags behind their real economic background) or of the sudden decline during the crisis.

In summing up the changes during the crisis, *we approach the third finding of this study. The changes took place gradually throughout Europe by layering, but the context of such layering shows significant differences in the various models*. The Nordic and continental countries continue the wire-dancing they have been performing since the 1990s, trying to find a balance between the liberalisation of the product and labour markets, holding the fort in global competition and maintaining the protection of the welfare system and social partnership; that is, their institutional systems are moving along the path of hybridisation. For the English-speaking countries, the imperative to regulate their financial sectors has meant a retreat from the liberalisation and deregulation concepts of the 1980s and 1990s. In the case of the Mediterranean countries, it is too early to see if the measures introduced as preconditions of the rescue packages have persistent effects and whether they will be able to formulate more efficient hybrid solutions than those before the crisis. In the CEE countries in which there were changes, these changes occurred by deepening the logic and characteristic features of the model (liberalisation on the product and the labour markets, integration in the global value chain through FDI, and maintaining competitiveness through keeping the social protection expenditures at a low level); thus, we can-

not speak about hybridisation, with the exception of the separate path taken by Hungary.

The extent of the GDP losses occurring during the crisis—as we have seen—did not fit into the models of capitalism. Drahokoupil and Myant (2015) point out that the VoC approach is criticised because it cannot provide an explanation for the different economic performance in the case of the post-socialist countries. The question may be put more generally: what is the institutional analysis suitable for, and what might it add to our understanding of the economic phenomena? If we compare the pre-crisis and the post-crisis periods, *a fourth lesson can be concluded* from this study, namely, that an overview of institutions may help us understand long-term economic performance and opportunities for development. When the macroeconomic processes still yielded very impressive results, the institutional analysis of the Mediterranean countries indicated that their economic institutions remained weak. When macroeconomic indicators still promised unlimited opportunities for convergence in the CEE countries, the scrutiny of the institutional factors drew attention to the constraints. These correlations have been expressly revealed by the empirical analysis performed with pre-crisis data in Part II. Undoubtedly, institutional analysis has its own limitations as well because the scope of the examined institutions must be drawn somewhere; thus, simplification is inevitable. Economic performance is evidently influenced by several non-institutional effects, for example, the size of the economy, demographical, geopolitical, and climatic conditions, and so on. From the driving factors of the crisis, it seems that in the short-term, the significance of the individual, non-institutional effects increases, but sometimes, already in the medium term, it can be seen that the influence of the institutional system on the performance of the economies becomes stronger. The Baltic countries, thanks to their flexible institutional system, began to grow quickly after their deep decline; although France did not slip into massive GDP losses, due to the institutional problems described in Chap. 6, it was not able to make its economy more dynamic by 2014.

Considering the above, I summarise what can be concluded about the development opportunities of the EU models of capitalism. The Nordic model can be maintained only if the higher level of social protection is coupled with intensive competition, an efficient innovation system,

a flexible labour market, and the institutionalisation of budgetary discipline, which has been implemented in Sweden in the most consistent way. If the North-Western continental countries want to maintain and/or strengthen their competitiveness and/preserve as much as possible from the provision of welfare benefits, they must also opt for this institutional combination. To do so, the institutional structure and the philosophy of their welfare system may remain persistently different. Indeed, since the 1990s, we have seen such institutional changes in the continental countries, to various depths, with variable consistency and with varied outcomes. If the North-Western continental countries' development proves to be successful, presumably, it will be accompanied by further institutional convergence. Only the position of France is dubious. If France does not introduce reforms on the basis of social consensus, it may drift towards the Mediterranean model.

Apart from certain regions in Northern Italy or in Spain, it is not realistic to assume that Mediterranean countries will follow the group of institutions characteristic of the Nordic or North-Western continental countries. Mediterranean countries' educational and innovation system, their SME sector and the performance of their public administrations do not provide enough basis for this shift. In order to achieve persistent stability, these countries, similar to the Visegrád countries—with all advantages and disadvantages of this path—need institutional changes through which the tradable sectors become stronger through FDI and integrated into the global value chain more deeply and disciplined budgetary policy becomes institutionalised. In other words, the Mediterranean model may converge with the CEE model. It is questionable, though, whether it is still reasonable to speak of the Mediterranean model as such after this kind of change.

For the less developed CEE countries, the current model also provides an opportunity for further convergence. The Czech Republic reached the limits of the model. On the basis of its institutional system, Estonia is the first country to be able to change its model, but it seems that the unfavourable circumstances (the decline in Finland and the consequences of the Russian-Ukrainian conflict) are holding back the development of this small economy. The stable Visegrád countries should surpass exactly those institutional weaknesses that have been indicated in the previ-

ous section in connection with the Mediterranean countries. Even if this breakthrough succeeded, it would not necessarily mean that these countries would be identified with one of the Western European models because the tradition of corporatist cooperation between employers and employees is missing.

Notes

1. It can also be concluded that by ignoring the performance of public administration, the theoretical framework of the VoC can be suitable for investigating only the Nordic countries and the North-Western countries.
2. The significance of subjective judgement is shown by the fact that the Czech Republic has jumped from 53rd place (2013–2014) to seventh place (2014–2015) in terms of out-of-control government spending, which expresses hope rather than reality one year after the change of government.
3. Pelle (2015) demonstrates that the current R&D&I policy at the EU level does not help decrease the R&D&I differences between the North-West and the South-East.
4. The less entrepreneur-friendly spirit of residents in the Eastern provinces of Germany illuminates why convergence within Germany slowed down (EC 2014: 27–28).

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11

Models of Capitalism and the Future of the European Integration

The diversity of the institutional systems, as revealed in the previous chapters, presents a major challenge for European economic integration. This chapter describes this challenge and its consequences. Obviously, this diversity is not the only challenge European integration must face. There are several challenges from outside the economy (environmental issues, climate change, the energy supply, migratory pressure, demographic problems, and so on) and from the globalised world economy (the non-decreasing backwardness in competitiveness compared to the USA and increasingly intense competition with the emerging countries), which all jeopardise the maintenance of the welfare model,[1] which model is generally known as the European social market economy. Nevertheless, the discussion of all these details is well outside the scope of this book. This chapter is dedicated to those aspects that result from the main topic of this book, that is, the study of the various models of European market economies and their coexistence.

B. Farkas, *Models of Capitalism in the European Union,*
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11.1 Worsening Convergence Prospects

The issues analysed in the institutional system and the institutional divide between the Nordic and North-Western countries and the Southern, CEE countries have all indicated the limitations of the income convergence among the member states. In the previous Parts, I take into account the results of mainstream economics, which will not change. The European Commission prepares a report every three years about the expected long-term economic impacts of ageing societies, published under the title of the Ageing Report. In this report, they forecast the evolution of potential GDP. The working group of the Committee builds the model on the neo-classic growth model and uses the production function in its econometric model. The report in 2009 (European Commission 2009a) did not calculate the effects of the crisis; nevertheless, a continuously worsening potential GDP growth rate has been projected for the entire EU until 2060. In post-socialist countries, the reduction of the growth rate seemed greater than in the entire EU, as triggered in the model by the expectedly greater decrease in the population. Naturally, it must always be added that the model does not take the future institutional and political changes into account. The report for 2012, which was published in 2011, built in only partially those effects of the crisis that are deteriorating the growth potential; nevertheless, the data show the further worsening of the prospects for convergence. It is remarkable that in the case of the model for 50 years, the report for 2012 calculates the convergence in the labour productivity growth rate instead of the convergence in productivity levels. In a footnote, an explanation is provided, namely, that to achieve the latter, a huge growth rate should have been assumed for the short- and medium-terms, which was not plausible (European Commission 2011b: 126). Halmai and Vásáry (2012: 319) calculate the expected per capita potential output at PPP in the various countries based on the model of the Ageing Report; the result of this was that 80 per cent of the EU-27 average would be achieved or exceeded only by the Czech Republic, Slovakia and Slovenia in 2060 among the post-socialist countries, and this result is already a reality in the Czech Republic and Slovenia. The Mediterranean countries would also sink under the EU average. The report made by the EBRD

(2013: 17) does not depict a more exhilarating picture, either. Their forecast until 2035 projects the decreasing growth rate of total factor productivity. Labour productivity measured in GDP per worker relative to the EU-15 will remain between 60–80 per cent in 20 years' time; only the Czech Republic and Slovakia will exceed 80 per cent. The report made by the IMF (2014) also draws our attention to the fact that the convergence of the post-socialist countries has been decelerating since the crisis.[2] All studies and reports have regarded the re-launching and accelerating of structural reforms as the potential way out.

The problem that has arisen within the EU is similar to that coined as the middle-income trap in literature, that is, that certain countries become stuck at a certain level of development. According to the World Bank's ranking, only Bulgaria, Romania and Hungary do not belong to the high-income countries among the EU member states (the latter slipped from the high-income countries to the middle-income countries in 2009), but processes and tensions within the EU are not determined by which global economic income group the countries belong to but rather by the income inequalities within the EU or, alternatively, within the convergence club. As discussed above, recently the analysts of the EU and the OECD have found that in order to continue the convergence in the CEE countries, it is inevitable to climb higher in the global value chain, as noted by Eichengreen et al. (2013), who regards this process as a remedy for the middle-income trap. Although this remedy in itself requires a very complicated adaptation process—as also noted above—an increasing number of findings of recent research indicate further difficulties. Based on her empirical survey and other data from the literature, Szalavetz (2014) points out that, on several occasions, the functional upgrading of subsidiaries of multinational companies did not result in capturing more value. Because it has become general in the emerging countries to move higher in the value chain, the increasing number of competitors puts pressure on the costs, but the asymmetric power relationships also make it difficult for the peripheral actors to reap the benefits of their upgrading results (for example, the suppliers' margins are often determined by the parent company). Sometimes, the parent company offshores high-value-added activities, but the newly available resources are directed to even more complex and knowledge-intensive activities;

thus, the proportion of the relative share of value does not change even if the distribution is fair. Functional upgrading usually results in obtaining higher added value in the case of an indigenous enterprise rather than in the case of a subsidiary of a multinational corporation. These experiences are in line with the concept we discuss in Chap. 4, that is, in order to continue convergence, it is not possible to give up developing an internationally competitive domestic economy.

Everything we have learned about the development and transition of the institutions and the groups of institutions anticipates that, although the countries are not pre-determined to fail, to overcome path dependency, it is extremely unlikely that all less developed member states of the EU will be able to embark on a development path that enables them to avoid getting stuck at a lower level of development. Therefore, institutional analysts are deeply dissatisfied with the generally applied approach in which the difficulties of convergence are presented, the reforms are encouraged and the related tasks are listed. If we think about the sustainable future of European integration, we must not forget the question of how the European integration can operate in the long term with countries at various levels of development. This issue should be reflected in the economic governance debate at the EU level.

11.2 The Future of the European Integration in Limited Convergence Prospects

In order to understand this problem, it is worth investigating first why it is so important to maintain convergence in European integration. The most obvious answer is that this convergence has always been included in the main objectives of the European integration from the Treaty of Rome to the Treaties currently in force. Article 3 of the consolidated version of the Treaty on the European Union (TEU) proclaims that "The Union shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment … It

shall promote economic, social and territorial cohesion, and solidarity among Member States". The Preamble of the TEU is expressly about economic convergence, and Article 121 of the Consolidated version of the Treaty on the Functioning of the EU is about "sustained convergence of the economic performances of the Member States". In less developed countries, economic convergence is the most attractive opportunity offered by the EU, and it serves as a basis for social acceptance.

Convergence is included in the integration not only at the level of legal and political objectives. Theories interpreting the economic effects of the integration (from the earliest customs union theories to the trade and common market theories, including the free movement of factors) are equilibrium theories with their roots in neoclassical economic theory, and the latter theories assume the international equalisation of factor costs and factor prices. In the economics of the European integration, the long-term growth effects of integration are represented with the help of the framework of neoclassical or endogenous growth theories, which include the idea of (conditional or absolute) convergence.[3]

When the monetary union was established, the issue of convergence particularly became the focus of attention, and at the same time, it was placed into a broader context. There was general agreement that the maintenance of the monetary union requires real and nominal convergence. The discussion was about how this status can be achieved. The starting point for the negotiations was the report made by the Delors Committee, which took the view that the monetary policy, the fiscal policy and the structural reforms of the real economy should be closely related and that economic and monetary integration should progress concurrently. The committee's assumption was that, if a government deviated from the commonly agreed budgetary guidelines or wage settlements, market forces would exert a disciplinary influence, but this influence might be either too slow or too sudden. Therefore, the Community would constitute a framework for the coordination of national economic policies. The Delors Committee clearly recognised the significance of institutional diversity, but it assumed that the risks and adverse effects of the EMU could be prevented by community-level, pre-designed institutions (Delors Committee 1989). This thinking is clearly represented in one of the figures in the Committee's study titled "One market, one money",

which assumes a one-way effect between community-level institutions and the behaviour of economic actors (Fig. 11.1). In the past 20–25 years, this approach has not changed one iota, and the reforms that came into existence during the six-year period of crisis management follow the same train of thought. The institutions designed at the community level are able to change the behaviour of the actors by combining sanctions and incentives.

The member states are usually categorised into two groups—the "economists" and the "monetarists"—on the basis of their arguing during the debate leading to the Maastricht Treaty (for example, Kenen 1995; Molle 2001). The "economists" (especially German and Dutch experts) were of the opinion that monetary integration is possible after achieving real convergence, and the monetary union was regarded as the "crowning" of the convergence process (in German, this is known as "*Krönungstheorie*"). The "monetarists" (especially Italian, French and Belgian experts) hoped that monetary integration might enforce tight control on inflation and induce changes in economic behaviour that facilitate real convergence. Finally, the specific content of the Maastricht Treaty was not determined by these theoretical debates but on political compromises, exactly the same way as in the scope of countries admitted to the euro area in 1998; however, by that time, the structural weaknesses of the Mediterranean countries was observable after the crisis of the European Monetary System in 1992–1993 (see Aglietta 1995).

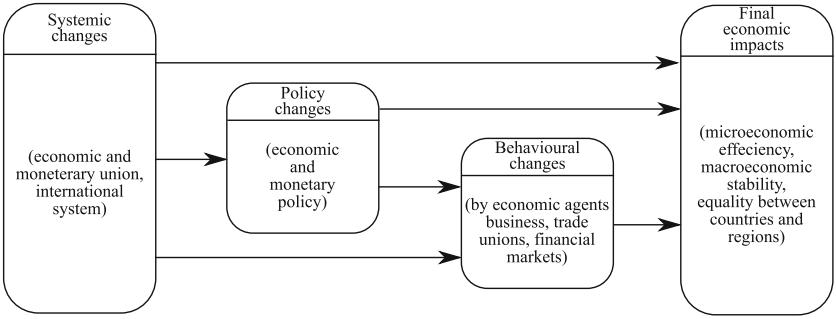

Fig. 11.1 Schema of the effects of EMU. *Source*: European Commission (1990: 12)

Thus, in the theories of economic integration and monetary union, the convergence of the real and nominal processes is an essential assumption. A different theoretical framework appeared only when the cohesion policy 2014–2020 was formulated. The Barca report—which was prepared at the request of the EU Commission (Barca 2009)—argues in favour of the place-based paradigm that derives from the findings of the new economic geography and new institutional economics. However, these approaches do not count on the appearance of equilibrium, that is, convergence. The report expressly declares that convergence measured in per capita GDP is not an objective of cohesion policy because the evolution of the productive potential of an area may occur as the result of prosperous agglomerations growing more quickly and the disparities between the centre and the periphery widening. The objective of cohesion policy is to facilitate the realisation of the economic potential of the regions and inclusive social development within the regions. The Barca report makes reference to the most important documents of the 1970s and 1980s (Werner, Thomson, and Padoa-Schioppa reports), and the key sentences of the old reports are cited, from which it is evident that their authors believe that not only the monetary union but also the common market would be unsustainable,[4] if the regional and structural inequalities deepened. These old authors view cohesion policy as a solution that is able to prevent such a case; this very task justifies its existence. The Barca report breaks with this old paradigm of cohesion policy without asking what will happen to the functionality of the common market or that of the monetary union if the cohesion policy is not able to facilitate convergence (and, according to the new economic geography and new institutional economics, market processes are not heading towards the direction of convergence). Although the legal regulation of the cohesion policy adopted several elements of the place-based paradigm, the Council of the European Union, in its decision to accept the Multiannual Financial Framework for 2014–2020, confirmed the reduction of the regional inequalities as an objective of cohesion policy. In the debates around the regulation and the budget of the cohesion policy, the deeper theoretical questions raised by the Barca report have remained unanswered (Farkas 2013).

In summary, econometric forecasts confirm the concerns awoken by the institutional studies in relation to the development prospects of European integration. In the economics of European integration, we cannot find a theoretical framework to solve this problem. The conception of conditional convergence may include the role of the institutions and the fact that several structural reforms are needed to restore or strengthen convergence. Nevertheless, no answer is given regarding the situation that is most likely to occur, namely, how the European integration will be able to survive in the long run if the reforms are not or are only partly successful in some countries.

Neglecting the problem of convergence itself—as the Barca report did—cannot be a solution, either. Let us take the example of the United Kingdom: politicians and scholars usually blame the monetary union for the problems within European integration, however the difficulties of the UK prove that even the common market and the "four freedoms" cannot function without real convergence. Since the crises in 2008, the country has experienced such massive immigration that it repeatedly comes up with the idea of limiting the free movement of workers. The asymmetric relationship between countries is well represented by the fact that the first firm step was not taken by the sender countries, which have been losing labour forces, but the country that has gained labour forces. The convergence of income levels is necessary to achieve that the free movement of workers indeed increases the economic performance of integration. Persistent one-way movement deteriorates the potential growth rate of the sender country and deranges its social security system, as we are talking about ageing societies with low fertility.[5] The Ukrainian crisis shows that in the geographical peripheries, such as the Baltic countries, migration may influence geopolitical stability as well.

No infallible remedy exists for the different institutional arrangements and the resulting problems of convergence. Nevertheless, as an institutional analyst, I think that the discussions on the reforms invariably begin with the second question: what reforms are needed to accelerate convergence and to reverse divergence in some countries. The first question is never asked: how large are those differences that still allow the internal market and/or the monetary union to remain functional: If we managed to model this on the economics of integration, we would be able

to see the minimum conditions of the functionality of the integration, and the related costs could be estimated. When all the above factors are taken into account, we may begin talking about how these minimum conditions can be achieved, which would also indicate the borders of intervention from the EU. Let us take an obvious example: if the per capita GDP in the Czech Republic cannot catch up with the EU average and becomes stuck at the level of 80 per cent, and this does not generate any obstacles in the free movement of the production factors and the economy creates no imbalances that may spill over to the economy of another member state, this will not jeopardise the functionality of the integration—although it means a certain loss of performance compared to the optimal conditions—and no EU intervention will be needed.

It is obvious that the functioning of a type of integration that has large institutional and cultural diversities can be managed less effectively and at higher costs (market transaction costs and redistributions costs alike) than a more homogenous integration, such as that of the USA. The countries have to make an attempt to decrease operational costs, while also being aware that institutional features may change very slowly and in an unpredictable manner, and the operational cost of integration must be compared to the alternative cost of the absence of integration. In this train of thought, the dispute about the common budget might be easier to handle, the contribution to which is always considered—expressly or tacitly—by the net contributors as the case of putting water into an empty barrel.

Interestingly, in political science, it has been long debated how heterogeneity within integration can be handled in formulating policies and in the decision-making mechanism; differentiated integration is discussed extensively in the literature, which gathered new impetus after the enlargement in the 2000s. The inequalities in development within the integration and the risk of persistent division between the centre and the periphery have come under scrutiny only recently in the theory of differentiated integration (Ágh 2014; von Ondarza 2013).

From the very beginning, there have been two main ways of thinking about European integration. One expects the realisation of the free market at the community level from the integration; the other expects community-level common policies and institutionalisation. These

approaches are well known as positive and negative integration. The two approaches could coexist (though with on-going debates and compromises) peacefully and even successfully with one another, and they relied on one another in the first three decades of integration. After the Mediterranean enlargement, heterogeneity increased to such a great extent that the effect of the community-level institutions on forming the behaviour of the actors weakened. Before the Maastricht Treaty, in the debate about nominal and real convergence, Italian experts expected direct external help from the community constraints against insufficient internal reform capacity and indigenous institutional weakness.[6] These expectations did not prove to be well-grounded, and in the end, Ludwig Erhard's writings in 1955, which warn against the weakness of community institutions in relation to integration if the agreement is missing in terms of the objectives, principles, and systems of activities and behaviour, became justified. Erhard also notes that we should not make the mistake of establishing increasingly newer institutions to obscure the tensions that result from a lack of agreement.[7] Political aspects and compromises, as well as the exaggerated expectations concerning the influence of community institutions, contributed to the fact that the resulting euro area has a composition that puts a disproportionate burden on its economically weaker members, causing disproportionate losses in their growth potential when adapting to external shocks without a depreciation of currency.

In post-socialist countries—as we have seen above—European integration successfully stimulated transition. The application of conditionality, however, was truly effective only until their intention to join the Western bloc impelled these countries and the non-recurrent, productivity-increasing effect of the transition from a planned economy to a market economy in the favourable global economic environment resulted in perceptible convergence. It is well documented that the reforms have slowed down or even come to a halt in recent years (see EBRD 2013). *The effectiveness of the conditions and regulations imposed by the external EU level decreases, and the significance of the commitment of the given state or society increases, if productivity growth must be ensured from a higher income level and with a more complex adaptation process.*

In summary, the EU has to manoeuvre between two adverse aspects. On the one hand, the EU cannot fail to support convergences at the community level that allow for a functioning internal market and a functioning monetary union. On the other hand, it must be reassessed what can be realistically expected from community-level institutions and regulations in such heterogeneous integration, and the member states must be made aware that their responsibility in making use of the advantages offered by the EU has increased.

The logic behind both central planning and equilibrium theories with neoclassical roots implies that a pre-determined final state can be achieved by bureaucracy, by the market or by the joint functioning of the two. *We must accept the situation in which we contemplate European integration*, *which is built on common values and principles*: *as an open-ended system*, *not as a well-defined final state*, *implying safety*. Differentiated integration is not a transitory deviation from the ideal situation to be achieved but rather a method for handling the differences.

European integration is invaluable in maintaining European political stability and peace; it is the only chance for Europe to remain a factor in the global economy among competitors with markets of hundreds of millions or a billion people. Reviving the European integration is a huge task that must be performed with conviction and commitment and without entertaining illusions.

Notes

1. Swedish experts have pointed out that the traditional advantages (for example, in Sweden, the developed infrastructure, knowledge of the English language, and cheap energy) are becoming increasingly less relevant because, in global competition, increasingly more countries are able to provide such benefits. The key to maintaining a high standard of living is the preservation of the competitiveness of the tradable sector, which depends principally on the ability to increase productivity (Alsén et al. 2013). This conclusion applies for all regions.
2. Éltető (2014) provides a comprehensive overview of the integration experience of the CEE countries and of the convergence measured in per capita GDP.

3. Beckmann et al. (2000) provide a comprehensive and detailed overview of the theoretical conceptions of European economic integration.
4. The different needs for convergence within and outside the euro area require further analysis.
5. Recently, the problem has arisen rather pointedly in Poland, where the decreasing amount of remittances indicates that an increasing proportion of foreign workers have decided to settle permanently. Furthermore, migrant women tend to have more children than do women who remain in their country of origin. http://uk.reuters.com/article/2014/12/05/uk-europe-demographics-poland-idUKKCN0JJ0KT20141205, date accessed 15 December 2014.
6. Dyson and Featherstone (1999) give a very interesting and detailed account of the political, politological, economic and social philosophical views that influenced the debates before the Maastricht Treaty.
7. Jede Integration aber - die politische und die wirtschaftliche - setzt immer eine vorherige Übereinstimmung hinsichtlich der Prinzipien, Systeme und Ziele des Handelns und Verhaltens voraus. Aus diesem Grunde sagte ich einleitend, daß vor jedem Versuch einer Integration der Wille zu einer Verständigung stehen muß. Verfallen wir nicht in den Fehler, Schwierigkeiten, Spannungen und Störungen sowohl im nationalen wie auch im internationalen Raum durch immer neue institutionelle und organisatorische Maßnahmen heilen oder—besser gesagt—überdecken zu wollen. Solcherart schieben wir die Probleme nur vor uns her, aber wir lösen sie nicht. Die Organisation ist immer nur die Form, aber die Funktion allein ist der Inhalt all unserer Bemühungen, die Zusammenarbeit der Völker auf eine höhere Ebene zu heben, ihr den Charakter einer echten Integration zu verleihen (Erhard 1955: 8).

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Appendix

Table A.1 Clusters of the product markets

Description of the clusters						
	1	2	3	4	5	Total
Number of the countries	(*n* = 11)	(*n* = 4)	(*n* = 6)	(*n* = 3)	(*n* = 1)	
Dimension 1. Market liberalisation						
Price controls (index)[a]						
Mean	4.49	8.85	4.40	6.67	4.40	5.56
Std. Deviation	1.12	1.16	0.04	1.15	0.00	1.11
Government enterprises and investment index[b]						
Mean	1.19	8.80	2.26	1.10	3.33	2.23
Std. Deviation	0.08	3.36	2.23	0.00	0.00	2.20
Highest marginal tax rate, corporate rate (%)[c]						
Mean	26.65	18.85	18.87	32.23	22.28	24.43
Std. Deviation	5.54	4.40	4.43	3.36	0.00	6.70
Highest marginal tax rate, individual rate (%)[c]						
Mean	43.37	32.20	28.80	37.79	38.80	37.73
Std. Deviation	9.98	15.55	6.63	7.78	0.00	11.12

(*Continued*)

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Table A.1 (Continued)

Description of the clusters						
	1	2	3	4	5	Total
Number of the countries	(*n* = 11)	(*n* = 4)	(*n* = 6)	(*n* = 3)	(*n* = 1)	
Paying taxes, total tax rate (% of proft)[d]						
Mean	47.77	40.00	47.78	62.27	35.50	47.78
Std. Deviation	12.27	4.42	7.76	13.30	0.00	11.15
Starting a business, procedures (number)[d]						
Mean	5.57	8.80	7.70	11.13	6.60	6.66
Std. Deviation	2.20	1.13	2.30	3.32	0.00	2.25
Starting a business, time (days)[d]						
Mean	12.27	34.45	17.73	32.27	26.60	20.02
Std. Deviation	6.68	19.95	6.67	17.72	0.00	13.38
Starting a business, cost (% of income per capita)[d]						
Mean	2.29	10.00	6.65	19.93	2.20	6.69
Std. Deviation	2.27	7.72	6.70	4.41	0.00	6.65
Starting a business, minimum capital (% of income per capita)[d]						
Mean	25.56	76.60	38.80	42.23	20.00	38.84
Std. Deviation	21.13	84.50	15.56	53.35	0.00	41.15
Dealing with licenses, procedures (number)[d]						
Mean	13.32	21.10	22.27	13.33	13.30	17.70
Std. Deviation	4.46	6.68	9.97	2.28	0.00	7.72
Dealing with licenses, time (days)[d]						
Mean	155.56	222.20	189.93	219.97	217.70	184.46
Std. Deviation	79.94	73.34	57.74	45.59	0.00	70.06
Dealing with licenses, cost (% of income per capita)[d]						
Mean	66.69	224.48	38.85	88.87	19.90	85.60
Std. Deviation	29.93	184.47	46.64	43.37	0.00	96.66
Registering property, procedures (number)[d]						
Mean	4.47	7.75	4.47	8.80	8.80	5.52
Std. Deviation	2.21	1.10	1.14	4.40	0.00	2.23
Registering property, time (days)[d]						
Mean	44.44	189.95	51.13	22.27	29.90	66.64
Std. Deviation	43.37	154.45	41.14	4.41	0.00	84.40

Description of the clusters						
	1	2	3	4	5	Total
Number of the countries	(*n* = 11)	(*n* = 4)	(*n* = 6)	(*n* = 3)	(*n* = 1)	
Registering property, cost (% of property value)[d]						
Mean	5.52	1.10	2.28	3.30	10.00	4.43
Std. Deviation	3.36	0.09	4.42	3.35	0.00	3.33
Paying taxes, payments (number per year)[d]						
Mean	12.25	44.40	18.80	14.47	22.20	19.98
Std. Deviation	6.67	36.68	9.91	6.61	0.00	18.82
Paying taxes, time (hours per year)[d]						
Mean	169.91	374.40	346.67	307.73	58.80	257.70
Std. Deviation	73.33	185.57	303.37	48.88	0.00	188.85
Enforcing contracts, procedures (number)[d]						
Mean	29.96	35.50	30.00	39.97	26.60	31.12
Std. Deviation	4.42	4.42	3.31	1.16	0.00	5.58
Enforcing contracts, time (days)[d]						
Mean	432.23	820.05	439.90	848.80	321.10	541.10
Std. Deviation	100.05	377.71	223.35	348.81	0.00	278.80
Enforcing contracts, cost (% of claim)[d]						
Mean	19.93	17.78	20.02	20.00	8.80	20.00
Std. Deviation	6.62	5.53	7.75	8.86	0.00	6.67
Closing a business, time (years)[d]						
Mean	1.14	2.20	3.37	1.10	2.20	2.29
Std. Deviation	0.01	0.02	1.14	0.03	0.00	1.10
Closing a business, cost (% of estate)[d]						
Mean	7.74	12.20	12.23	15.53	15.50	10.00
Std. Deviation	4.43	6.68	4.42	6.61	0.00	5.58
Closing a business, recovery rate[d]						
Mean	76.66	33.33	37.77	61.17	41.10	57.78
Std. Deviation	14.40	8.87	9.99	16.66	0.00	22.24
Dimension 2. International integration						
Trade integration of goods[e]						
Mean	36.65	43.33	58.86	19.97	44.43	41.15
Std. Deviation	14.48	11.17	10.07	3.38	0.00	16.67

(*Continued*)

Table A.1 (Continued)

Description of the clusters						
	1	2	3	4	5	Total
Number of the countries	(*n* = 11)	(*n* = 4)	(*n* = 6)	(*n* = 3)	(*n* = 1)	
Trade integration of services[e]						
Mean	12.20	8.88	11.10	7.72	87.77	13.38
Std. Deviation	7.71	4.42	3.36	3.33	0.00	16.62
Balance of international trade in goods (%of GDP)[e]						
Mean	2.27	–8.87	–9.92	–7.70	–10.07	–3.36
Std. Deviation	7.78	7.79	8.90	6.61	0.00	9.91
Balance of international trade in services (% of GDP)[e]						
Mean	0. 594	1.16	2.29	3.31	43.33	3.39
Std. Deviation	2.23	1.11	2.22	4.46	0.00	8.86
Inward FDI stock, % of GDP[f]						
Mean	59.97	46.63	56.62	23.37	60.00	52.25
Std. Deviation	39.96	31.16	16.64	11.12	0.00	31.10
Outward FDI stock, % of GDP[f]						
Mean	62.25	5.53	8.88	26.67	191.10	41.15
Std. Deviation	32.22	5.59	9.97	17.70	0.00	46.60
Distances between cluster centres						
Cluster	1	2	3	4	5	
1		6.77	4.44	5.79	8.43	
2	6.77		5.00	5.85	10.16	
3	4.44	5.00		5.86	8.86	
4	5.79	5.85	5.86		10.02	
5	8.43	10.16	8.86	10.02		

Source:
[a]Gwartney–Lawson (2008) Annual report, data 2006
[b]Gwartney–Lawson (2008) Annual report, average of the data 2004–2006
[c]World Bank (2007b), data 2006
[d]World Bank (2007a) data 2007
[e]Eurostat, average of the data 2004–2006
[f]UNCTAD (2008), data 2007

Table A.2 Clusters of research and development and innovation system

Description of the clusters					
	1	2	3	4	Total
Number of the countries	(*n* = 3)	(*n* = 1)	(*n* = 7)	(*n* = 14)	
Research and development expenditure, % of GDP[a]					
Mean	3.23	1.56	1.94	0.84	1.46
Std. Deviation	0.64	0.00	0.41	0.35	0.91
Gross domestic expenditure on R&D (GERD) by source of funds; Business enterprise sector (%)[b]					
Mean	66.88	80.05	52.78	37.81	47.18
Std. Deviation	1.20	0.00	6.96	9.67	14.72
Gross domestic expenditure on R&D (GERD) by source of funds; Government sector (%)[b]					
Mean	26.48	13.90	31.94	50.21	40.79
Std. Deviation	3.30	0.00	5.02	9.19	13.54
Human resources in science and technology as a share of labour force (%)[c]					
Mean	46.82	43.35	43.76	33.41	38.32
Std. Deviation	2.96	0.00	4.59	6.54	7.87
Exports of high technology products as a share of total exports (%)[a]					
Mean	15.99	36.04	17.82	6.78	12.15
Std. Deviation	2.91	0.00	7.40	4.84	8.88
Employment in high- and medium-high-technology manufacturing sectors, share of total employment (%)[a]					
Mean	40.60	41.49	38.24	24.86	31.16
Std. Deviation	6.90	0.00	4.61	3.77	8.39
European high-technology patents (per million inhabitants)[b]					
Mean	46.65	10.09	19.85	1.30	12.29
Std. Deviation	25.79	0.00	8.75	1.59	17.63
Patents granted by the United States Patent and Trademark Office (USPTO), Number of patents per million[d]					
Mean	131.85	112.50	61.97	4.67	40.29
Std. Deviation	6.82	0.00	13.64	7.59	47.16
Gross domestic expenditure on R&D (GERD) by source of funds; Abroad (%)[b]					
Mean	4.84	5.95	12.66	9.51	9.69
Std. Deviation	2.40	0.00	4.54	5.73	5.44

(*Continued*)

Table A.2 (Continued)

Description of the clusters					
	1	2	3	4	Total
Number of the countries	(*n* = 3)	(*n* = 1)	(*n* = 7)	(*n* = 14)	
Employment in knowledge-intensive service sectors, Share of total employment (%)[a]					
Mean	8.07	1.28	5.75	5.56	5.74
Std. Deviation	2.35	0.00	1.11	2.71	2.50
Distances between cluster centres					
Cluster	1	2	3	4	
1		4.71	3.29	6.09	
2	4.71		3.99	6.42	
3	3.29	3.99		3.61	
4	6.09	6.42	3.61		

Source:
[a]Eurostat, average of the data 2004–2006
[b]Eurostat, average of the data 2003–2005
[c]Eurostat, average of the data 2005–2007
[d]Eurostat, average of the data 2000–2002

Table A.3 Clusters of the financial system

Description of the clusters						
	1	2	3	4	5	Total
Number of the countries	(*n* = 3)	(*n* = 1)	(*n* = 10)	(*n* = 2)	(*n* = 9)	
Bank capital to assets ratio (%)[a]						
Mean	6.04	4.70	8.63	6.35	5.64	6.90
Std. Deviation	3.05	0.00	1.52	3.32	0.84	2.12
Bank deposits/GDP[b]						
Mean	0.63	3.34	0.39	1.14	0.79	0.74
Std. Deviation	0.29	0.00	0.12	0.12	0.17	0.61
Bank overhead costs/Total assets[b]						
Mean	0.03	0.01	0.03	0.03	0.03	0.03
Std. Deviation	0.01	0.00	0.01	0.01	0.01	0.01
Deposit money bank assets/GDP[b]						
Mean	0.98	1.24	0.46	1.64	1.31	0.96
Std. Deviation	0.21	0.00	0.15	0.12	0.25	0.47
Domestic credit provided by banking sector (% of GDP)[a]						
Mean	97.38	108.66	44.82	165.31	130.46	94.15
Std. Deviation	22.13	0.00	14.65	9.41	21.76	47.15
Private credit by deposit money banks/GDP[b]						
Mean	0.83	1.19	0.37	1.58	1.17	0.84
Std. Deviation	0.20	0.00	0.12	0.05	0.29	0.47
Bank concentration (Share of the 5 largest CIs in total assets)[b]						
Mean	0.94	0.29	0.68	0.54	0.68	0.69
Std. Deviation	0.06	0.00	0.15	0.03	0.16	0.18
Herfindahl index for CIs (index ranging from 0 to 10,000)[c]						
Mean	1855.22	294.00	1357.63	1131.33	676.70	1111.56
Std. Deviation	886.94	0.00	885.44	1014.46	363.37	799.75

(*Continued*)

Table A.3 (Continued)

Description of the clusters						
	1	2	3	4	5	Total
Number of the countries	(*n* = 3)	(*n* = 1)	(*n* = 10)	(*n* = 2)	(*n* = 9)	
Share of the 5 largest CIs in total assets in per cent[c]						
Mean	75.07	29.23	65.23	61.47	48.10	58.50
Std. Deviation	14.22	0.00	14.76	33.71	16.52	19.16
Total assets under management by insurance corporations/GDP[c]						
Mean	0.69	1.66	0.06	1.08	0.43	0.42
Std. Deviation	0.33	0.00	0.04	0.62	0.23	0.45
Total assets under management by investment funds/GDP[c]						
Mean	0.41	50.84	0.04	0.25	0.64	2.35
Std. Deviation	0.21	0.00	0.03	0.08	0.78	10.12
Life insurance premium volume/GDP[b]						
Mean	0.06	0.30	0.01	0.07	0.04	0.04
Std. Deviation	0.01	0.00	0.01	0.03	0.03	0.06
Total assets under management by pension funds/GDP[c]						
Mean	0.06	0.00	0.04	1.22	0.08	0.15
Std. Deviation	0.07	0.00	0.04	0.12	0.09	0.33
Non-life insurance premium volume/GDP[b]						
Mean	0.03	0.04	0.02	0.05	0.03	0.03
Std. Deviation	0.01	0.00	0.01	0.00	0.01	0.01
Market capitalisation of listed companies (% of GDP)[a]						
Mean	109.68	139.53	22.22	119.57	56.28	57.46
Std. Deviation	8.68	0.00	9.48	22.96	19.05	40.55
Stock market turnover[b]						
Mean	0.87	0.01	0.29	1.18	0.83	0.61
Std. Deviation	0.58	0.00	0.24	0.14	0.44	0.48

Description of the clusters						
	1	2	3	4	5	Total
Number of the countries	(n = 3)	(n = 1)	(n = 10)	(n = 2)	(n = 9)	
Stock market capitalisation/GDP[b]						
Mean	1.01	1.26	0.19	1.11	0.51	0.52
Std. Deviation	0.08	0.00	0.09	0.22	0.18	0.38
Stock market total value traded/GDP[b]						
Mean	0.84	0.01	0.06	1.32	0.46	0.40
Std. Deviation	0.55	0.00	0.07	0.42	0.33	0.47
Distances between cluster centres						
Cluster	1	2	3	4	5	
1		2.31	1.14	1.27	0.86	
2	2.31		3.32	1.06	2.29	
3	1.14	3.32		2.26	1.15	
4	1.27	1.06	2.26		1.27	
5	0.86	2.29	1.15	1.27		

Source:
[a]World Development Indicators, average of the data 2003–2005
[b]Beck et al. (2000) average of the data 2004–2006
[c]European Central Bank (2008), data 2007

Table A.4 Clusters of the labour markets and industrial relations

Description of the cluster						
	1	2	3	4	5	Total
Number of the countries	(*n* = 11)	(*n* = 3)	(*n* = 1)	(*n* = 8)	(*n* = 2)	
Employees with a contract of limited duration (annual average) (% of total number of employees)[a]						
Mean	8.47	11.60	16.73	16.44	5.32	11.47
Std. Deviation	7.00	4.62	0.00	8.17	0.73	7.64
Persons employed part-time (% of total employment)[a]						
Mean	6.98	23.18	46.15	15.73	21.08	14.42
Std. Deviation	3.45	1.35	0.00	5.31	6.05	9.80
Public expenditure on labour market policies, by type of action; Total LMP services (category 1), % of GDP[b]						
Mean	0.07	0.19	0.48	0.15	0.30	0.15
Std. Deviation	0.04	0.03	0.00	0.08	0.12	0.11
Public expenditure on labour market policies, by type of action; Total LMP measures (categories 2–7)[b]						
Mean	0.21	1.16	0.83	0.53	0.26	0.45
Std. Deviation	0.15	0.32	0.00	0.18	0.30	0.36
Public expenditure on labour market policies, by type of action; Total LMP supports (categories 8–9), % of GDP[b]						
Mean	0.37	1.89	1.85	1.36	0.53	0.94
Std. Deviation	0.23	0.76	0.00	0.61	0.48	0.75
Trade union density (%)[c]						
Mean	21.40	66.39	21.53	31.22	32.90	30.86
Std. Deviation	7.24	11.51	0.00	20.56	5.52	18.98
Bargaining coverage %[c]						
Mean	38.50	90.00	82.00	81.25	34.77	59.80
Std. Deviation	23.52	7.21	0.00	17.27	0.33	29.49
Coordination of wage bargaining (1–5)[c]						
Mean	2.27	3.33	4.00	3.25	3.00	2.84
Std. Deviation	1.27	0.58	0.00	0.89	2.83	1.25
Difficulty of hiring index[d]						
Mean	31.73	9.33	17.00	51.38	11.00	33.08
Std. Deviation	21.22	8.62	0.00	24.69	0.00	24.61
Rigidity of hours index[d]						
Mean	63.64	40.00	40.00	62.50	10.00	55.20
Std. Deviation	17.48	20.00	0.00	7.07	14.14	21.04

Description of the cluster						
	1	2	3	4	5	Total
Number of the countries	(n = 11)	(n = 3)	(n = 1)	(n = 8)	(n = 2)	
Difficulty of firing index[d]						
Mean	32.73	20.00	70.00	41.25	15.00	34.00
Std. Deviation	14.89	17.32	0.00	6.41	7.07	16.07
Rigidity of employment index[d]						
Mean	42.82	23.00	42.00	51.75	12.00	40.80
Std. Deviation	12.42	14.73	0.00	9.05	7.07	16.09
Nonwage labour cost (% of salary)[d]						
Mean	30.18	29.33	18.00	26.50	11.00	26.88
Std. Deviation	5.44	27.10	0.00	10.58	0.00	11.67
Firing cost (weeks of salary)[d]						
Mean	18.91	14.00	17.00	44.88	23.00	26.88
Std. Deviation	11.19	13.11	0.00	28.38	1.41	21.55
Employment rate[a]						
Mean	60.88	70.48	74.50	66.75	70.02	65.19
Std. Deviation	4.09	8.09	0.00	2.39	2.24	5.71
Unemployment rate[a]						
Mean	8.41	6.37	3.93	7.22	4.83	7.32
Std. Deviation	2.76	2.01	0.00	1.96	0.47	2.51
Long-term unemployed (12 months and more) as a percentage of the total active population[a]						
Mean	4.56	2.03	1.63	2.73	1.30	3.29
Std. Deviation	2.31	1.82	0.00	1.43	0.19	2.14
Unemployment rate, by age group; Less than 25 years, %[a]						
Mean	19.27	16.37	6.90	15.60	11.25	16.61
Std. Deviation	5.96	7.19	0.00	3.74	3.46	5.80
Distances between cluster centres						
Cluster	1	2	3	4	5	
1		5.82	8.04	3.63	5.54	
2	5.82		5.96	4.46	4.92	
3	8.04	5.96		5.89	6.29	
4	3.63	4.46	5.89		5.58	
5	5.54	4.92	6.29	5.58		

Source:
[a]Eurostat, average of the data 2005–2007
[b]Eurostat, average of the data 2004–2006
[c]Visser (2009)
[d]World Bank (2007a)

Table A.5 Clusters of the social protection system

Description of the cluster					
	1	2	3	4	Total
Number of the countries	(*n* = 4)	(*n* = 1)	(*n* = 13)	(*n* = 7)	
Health expenditure, total (% of GDP)[a]					
Mean	6.84	5.58	6.39	4.67	5.95
Std. Deviation	0.96	0.00	1.27	1.12	1.40
Health expenditure, public (% of GDP)[a]					
Mean	1.32	1.62	2.42	1.85	2.06
Std. Deviation	0.42	0.00	0.65	0.89	0.78
Health expenditure, private (% of GDP)[a]					
Mean	8.17	7.20	8.81	6.52	8.00
Std. Deviation	0.93	0.00	1.26	0.98	1.47
Inequality of income distribution[b]					
Mean	3.61	4.95	4.87	5.13	4.74
Std. Deviation	0.27	0.00	1.10	1.49	1.20
Expenditure on pensions Current prices (% of GDP)[c]					
Mean	11.18	4.83	12.03	7.09	10.23
Std. Deviation	1.11	0.00	1.76	0.93	2.82
At-risk-of-poverty rate before social transfers (%)[b]					
Mean	27.50	32.50	25.69	23.07	25.52
Std. Deviation	2.68	0.00	2.76	3.51	3.50
At-risk-of-poverty rate after social transfers (%)[b]					
Mean	12.13	19.00	15.96	16.36	15.58
Std. Deviation	1.25	0.00	3.68	4.22	3.76
Total expenditure on social protection, Current prices (% of GDP)[c]					
Mean	28.00	18.07	25.71	15.17	22.82
Std. Deviation	4.65	0.00	3.70	2.59	6.18
Social benefits (other than social transfers in kind) paid by general government (% of GDP)[d]					
Mean	15.30	9.50	15.27	10.14	13.61
Std. Deviation	1.11	0.00	2.42	1.85	3.18
Social benefits by function; Sickness/Health care (% of total benefits)[c]					
Mean	24.15	40.30	28.14	30.61	28.68
Std. Deviation	2.37	0.00	3.30	3.42	4.40
Social benefits by function; Family/Children (% of total benefits)[c]					
Mean	12.89	14.86	7.47	9.50	9.20
Std. Deviation	3.21	0.00	2.60	1.76	3.27

Description of the cluster					
	1	2	3	4	Total
Number of the countries	(n = 4)	(n = 1)	(n = 13)	(n = 7)	
Social benefits by function; Old age (% of total benefits)[c]					
Mean	33.74	21.87	42.59	43.64	40.64
Std. Deviation	5.50	0.00	5.90	3.26	7.15
Social benefits by function; Disability (% of total benefits)[c]					
Mean	13.80	5.03	8.31	8.88	9.22
Std. Deviation	0.77	0.00	2.04	0.81	2.65
Social benefits by function; Housing (% of total benefits)[c]					
Mean	1.49	3.03	1.37	0.26	1.14
Std. Deviation	0.74	0.00	1.56	0.27	1.32
Social benefits by function; Unemployment (% of total benefits)[c]					
Mean	7.43	7.80	6.00	3.07	5.48
Std. Deviation	2.45	0.00	3.45	1.41	3.15
Social protection receipts by type; General government contributions (% of total receipts)[e]					
Mean	50.16	53.17	34.71	27.99	36.04
Std. Deviation	8.91	0.00	7.72	9.63	11.32
Social protection receipts by type; Employers' social contribution (% of total receipts)[e]					
Mean	29.24	26.07	37.38	53.43	40.12
Std. Deviation	13.90	0.00	7.44	12.33	13.17
Social protection receipts by type; Social contribution paid by the protected persons (% of total receipts)[e]					
Mean	15.92	15.83	22.65	15.42	19.27
Std. Deviation	7.18	0.00	8.19	8.98	8.55
Distances between cluster centres					
Cluster	1	2	3	4	
1		6.93	4.17	6.02	
2	6.93		6.86	6.66	
3	4.17	6.86		4.31	
4	6.02	6.66	4.31		

Source:
[a]World Development Indicators, average of the data 2002–2004
[b]Eurostat, average of the data 2005–2006
[c]Eurostat, average of the data 2003–2005
[d]Eurostat, average of the data 2005–2007
[e]Eurostat, average of the data 2004–2006

Table A.6 Clusters of the education system

Description of the clusters					
	1	2	3	4	Total
Number of the countries	(*n* = 7)	(*n* = 3)	(*n* = 10)	(*n* = 5)	
Percentage of the population aged 25–64 having completed at most lower secondary education[a]					
Mean	21.48	57.34	25.98	15.37	26.36
Std. Deviation	4.40	13.42	10.42	5.91	14.78
Early school-leavers—Percentage of the population aged 18–24 with at most lower secondary education and not in further education or training[a]					
Mean	10.25	29.76	13.73	9.89	13.91
Std. Deviation	3.03	8.71	2.79	5.69	7.46
Total population having completed at least upper secondary education, Population aged 25–64 (%)[a]					
Mean	78.52	42.66	74.02	84.63	73.64
Std. Deviation	4.40	13.42	10.42	5.91	14.78
Youth education attainment level—Percentage of the population aged 20–24 having completed at least upper secondary education[a]					
Mean	82.38	62.43	81.50	85.31	80.22
Std. Deviation	6.03	12.26	4.95	9.00	9.55
Pupils in upper secondary education enrolled in vocational stream; Males, (%)[b]					
Mean	66.10	50.79	48.58	69.89	58.01
Std. Deviation	10.19	18.96	16.93	11.50	16.66
Pupils in upper secondary education enrolled in vocational stream; Females, (%)[b]					
Mean	59.72	38.14	38.02	55.41	47.59
Std. Deviation	10.62	12.62	18.45	16.50	17.88
School enrolment, tertiary (% gross)[c]					
Mean	67.81	59.26	54.74	43.99	56.79
Std. Deviation	13.08	4.19	18.42	9.89	16.12
Life-long learning (adult participation in education and training)—Percentage of the population aged 25–64 participating in education and training over the four weeks prior to the survey[a]					
Mean	22.19	6.90	5.67	4.74	10.26
Std. Deviation	7.64	3.19	2.45	2.32	8.76
Science and technology graduates (ISCED 5–6) in mathematics, science and technology per 1000 of population aged 20–29[b]					
Mean	12.78	10.47	11.59	8.82	11.23
Std. Deviation	4.10	0.96	6.83	0.96	4.90

Description of the clusters					
	1	2	3	4	Total
Number of the countries	(*n* = 7)	(*n* = 3)	(*n* = 10)	(*n* = 5)	
Annual expenditure on public and private educational institutions compared to GDP per capita; All levels of education, (%—based on full-time equivalents)[d]					
Mean	26.54	25.71	22.40	23.59	24.20
Std. Deviation	2.55	1.34	2.98	2.20	3.04
Annual expenditure on public and private educational institutions compared to GDP per capita; Tertiary level of education (ISCED 5–6), (%—based on full-time equivalents)[d]					
Mean	42.45	32.23	32.24	40.25	36.70
Std. Deviation	5.00	3.67	6.13	5.76	7.08
Public expenditure on education, % of GDP[d]					
Mean	6.24	4.75	4.83	4.58	5.17
Std. Deviation	1.16	0.60	0.90	0.49	1.09
Private expenditure on education as % of GDP[d]					
Mean	0.50	0.40	0.40	0.66	0.48
Std. Deviation	0.34	0.18	0.22	0.15	0.25
Employment rate, by highest level of education attained; Pre-primary, primary and lower secondary education—levels 0–2 (ISCED), % of age group 25–64 years[a]					
Mean	53.27	56.26	39.77	26.89	42.95
Std. Deviation	7.63	9.74	9.63	10.99	13.73
Employment rate, by highest level of education attained; Upper secondary and post-secondary non-tertiary education—levels 3–4 (ISCED), % of age group 25–64 years[a]					
Mean	76.15	66.30	67.77	67.62	69.91
Std. Deviation	3.74	1.88	4.10	5.43	5.57
Employment rate, by highest level of education attained; Tertiary education—levels 5–6 (ISCED), % of age group 25–64 years[a]					
Mean	86.39	81.40	83.86	83.29	84.16
Std. Deviation	0.97	3.32	2.67	1.19	2.58
Unemployment rates of the population aged 25–64 by level of education; Pre-primary, primary and lower secondary education—levels 0–2 (ISCED), Annual average[a]					
Mean	7.16	8.05	10.08	25.68	12.14
Std. Deviation	1.84	1.39	3.55	11.40	8.76

(*Continued*)

Table A.6 (Continued)

Description of the clusters					
	1	2	3	4	Total
Number of the countries	(*n* = 7)	(*n* = 3)	(*n* = 10)	(*n* = 5)	
Unemployment rates of the population aged 25–64 by level of education; Upper secondary and post-secondary non-tertiary education—levels 3–4 (ISCED), Annual average[a]					
Mean	4.40	6.16	6.00	8.97	6.17
Std. Deviation	1.36	1.32	1.64	2.95	2.37
Unemployment rates of the population aged 25–64 by level of education; Tertiary education—levels 5–6 (ISCED), Annual average[a]					
Mean	3.03	5.39	3.56	3.65	3.65
Std. Deviation	0.76	0.46	1.34	1.18	1.25
Distances between cluster centres					
Cluster	1	2	3	4	
1		6.64	4.24	5.20	
2	6.64		4.86	6.91	
3	4.24	4.86		3.61	
4	5.20	6.91	3.61		

Source:
[a]Eurostat, average of the data 2005–2007
[b]Eurostat, average of the data 2004–2006
[c]World Bank (2007b), average of the data 2002–2004
[d]Eurostat, average of the data 2003–2005

Table A.7 Assessment of the EU member states' overall Lisbon performance, ranking by the Lisbon indicators, 2005–2009

	Rank 2009	Rank 2008	Rank 2007	Rank 2006	Rank 2005
Sweden	1	1	2	2	2
Austria	2	4	3	5	3
Denmark	3	2	1	1	1
The Netherlands	4	3	4	3	5
Finland	5	5	5	6	6
Germany	6	8	8	9	10
Ireland	7	6	6	8	7
United Kingdom	8	7	7	4	4
France	9	10	9	11	8
Czech Republic	10	9	14	10	12
Slovenia	11	14	10	12	11
Luxembourg	12	12	12	7	9
Belgium	13	13	13	13	13
Cyprus	14	15	15	14	14
Estonia	15	11	11	15	16
Lithuania	16	17	18	20	20
Latvia	17	16	17	18	19
Slovakia	18	18	20	23	22
Spain	19	19	16	17	21
Portugal	20	21	21	16	18
Poland	21	24	26	27	26
Greece	22	20	19	22	17
Hungary	23	23	22	19	15
Italy	24	22	23	21	23
Bulgaria	25	25	25	24	24
Romania	26	26	24	25	25
Malta	27	27	27	26	27

Source: Barysch et al. (2007: 12, 2008: 12), Tilford-Whyte (2010: 11)

List of Lisbon indicators: GDP per capita; Labour productivity; Employment rate; Employment rate of older workers; Female participation rate; Educational attainment; Research and Development expenditure; Business investment; Comparative price levels; At risk-of-poverty rate; Long-term unemployment rate; Dispersion of regional employment rates; Greenhouse gas emissions; Energy intensity; and Volume of freight transport.

Table A.8 Poverty risk and social inequalities in the EU in 2008 and 2013

	At-risk-of-poverty rate				People at risk of poverty or social exclusion[a]		Gini coefficient		Income quintile share ratio (S80/S20)	
	Before social transfers		After social transfers							
	2008	2013	2008	2013	2008	2013	2008	2013	2008	2013
EU-27	25.3	25.8	16.6	16.6	23.8	24.4	30.9	30.5	5.0	5.0
Belgium	27.0	26.3	14.7	15.1	20.8	20.8	27.5	25.9	4.1	3.8
Bulgaria	27.1	26.7	21.4	21.0	44.8	48.0	35.9	35.4	6.5	6.6
Czech Republic	20.0	16.6	9.0	8.6	15.3	14.6	24.7	24.6	3.4	3.4
Denmark	27.8	28.1	11.8	12.3	16.3	18.9	25.1	27.5	3.6	4.3
Germany	24.2	24.4	15.2	16.1	20.1	20.3	30.2	29.7	4.8	4.6
Estonia	24.7	25.4	19.5	18.6	21.8	23.5	30.9	32.9	5.0	5.5
Ireland	34.0	39.3	15.5	15.7	23.7	30.0	29.9	29.9	4.4	4.7
Greece	23.3	28.0	20.1	23.1	28.1	35.7	33.4	34.4	5.9	6.6
Spain	25.2	30.0	20.8	20.4	24.5	27.3	31.9	33.7	5.7	6.3
France	23.5	24.2	12.5	13.7	18.5	18.1	29.8	30.1	4.4	4.5
Croatia	25.3	29.7	17.3	19.5		29.9	28.0	30.9	4.5	5.3
Italy	23.4	24.6	18.7	19.1	25.3	28.4	31.0	32.5	5.1	5.7
Cyprus	22.9	24.3	15.9	15.3	23.3	27.8	29.0	32.4	4.3	4.9
Latvia	30.2	26.0	25.9	19.4	34.2	35.1	37.5	35.2	7.3	6.3
Lithuania	27.2	30.3	20.0	20.6	27.6	30.8	34.0	34.6	5.9	6.1
Luxembourg	23.6	29.4	13.4	15.9	15.5	19.0	27.7	30.4	4.1	4.6
Hungary	30.4	26.3	12.4	14.3	28.2	33.5	25.2	28.0	3.6	4.2
Malta	22.9	23.3	15.3	15.7	20.1	24.0	28.1	27.9	4.3	4.1
The Netherlands	19.9	20.8	10.5	10.4	14.9	15.9	27.6	25.1	4.0	3.6
Austria	25.9	25.9	15.2	14.4	20.6	18.8	27.7	27.0	4.2	4.1
Poland	25.1	23.0	16.9	17.3	30.5	25.8	32.0	30.7	5.1	4.9

Portugal	24.9	25.5	18.5	18.7	26.0	27.4	35.8	34.2	6.1	6.0
Romania	30.7	27.8	23.4	22.4	44.2	40.4	36.0	34.0	7.0	6.6
Slovenia	23.0	25.3	12.3	14.5	18.5	20.4	23.4	24.4	3.4	3.6
Slovakia	18.4	20.1	10.9	12.8	20.6	19.8	23.7	24.2	3.4	3.6
Finland	27.3	26.4	13.6	11.8	17.4	16.0	26.3	25.4	3.8	3.6
Sweden	28.5	27.1	12.2	14.8	14.9	16.4	24.0	24.9	3.5	3.7
United Kingdom	28.9	30.1	18.7	15.9	23.2	24.8	33.9	30.2	5.6	4.6

Source: Eurostat

Note: Ireland's data are of 2012

[a]This indicator of the Europe 2020 strategy corresponds to the sum of persons who are: at risk of poverty or severely materially deprived or living in households with very low work intensity. Persons are only counted once even if they are present in several sub-indicators. At risk-of-poverty are persons with an equivalised disposable income below the risk-of-poverty threshold which is set at 60 % of the national median equivalised disposable income (after social transfers). Material deprivation covers nine items relating to the economic strain and durables of a household. People severely materially deprived are those with an enforced lack of at list four of these items. People living in households with very low work intensity are those aged 0–59 living in households where the adults (aged 18–59) worked less than 20 % of their total work potential during the past year. Students are excluded. Data are expressed both in % of total population and in change over three years (in % points).

Table A.9 FDI flows as a percentage of gross fixed capital formation and FDI stock as percentage of gross domestic products in the EU 27 member states

		FDI flows as % of gross fixed capital formation			FDI stock as % of GDP			Inward/Outward FDI stock
		2005	2006	2007	1990	2000	2007	2007
Austria	Inward	17.40	9.30	39.70	6.60	15.70	34.00	1.00
	Outward	18.00	14.50	40.70	2.90	12.80	34.00	
Belgium	Inward	45.00	78.10	42.00			165.20	1.22
	Outward	42.70	68.70	51.30			135.30	
Bulgaria	Inward	59.70	91.40	71.60	0.50	21.50	92.30	61.53
	Outward	4.70	2.10	2.30	0.60	0.50	1.50	
Cyprus	Inward	35.70	40.40	46.90		31.30	86.50	2.75
	Outward	16.80	23.00	24.00	0.10	6.00	31.40	
Czech Republic	Inward	37.40	17.10	21.60		38.20	57.70	14.35
	Outward	–0.10	4.20	3.20		1.30	4.00	
Denmark	Inward	25.20	6.00	15.70	6.80	46.00	47.10	0.88
	Outward	31.70	14.20	23.80	5.40	45.70	53.30	
United Kingdom	Inward	46.20	34.60	44.80	20.60	30.40	48.60	0.79
	Outward	20.80	20.30	53.10	23.10	62.30	61.50	
Estonia	Inward	67.40	29.60	36.60		47.00	78.00	2.82
	Outward	14.70	19.50	22.60		4.60	27.60	
Finland	Inward	12.90	13.60	17.10	3.70	19.90	34.80	0.75
	Outward	11.50	7.80	17.40	8.00	42.80	46.20	
France	Inward	20.10	17.00	29.40	7.90	19.60	40.10	0.73
	Outward	27.10	26.40	41.80	9.10	33.50	54.70	
Greece	Inward	1.00	7.80	2.40	6.20	11.20	16.90	1.72
	Outward	2.50	6.00	6.30	3.10	4.90	9.80	
The Netherlands	Inward	39.70	6.00	65.10	23.10	63.30	87.90	0.79
	Outward	113.20	35.70	20.40	35.90	79.30	111.20	

Ireland	Inward	–60.60	–9.60	47.50	79.40	131.90	73.60	1.29
	Outward	27.40	26.50	32.30	31.20	29.00	56.70	
Poland	Inward	18.70	28.50	18.70	0.20	20.00	33.80	7.19
	Outward	6.10	13.20	3.60	0.10	0.60	4.70	
Latvia	Inward	14.50	25.60	24.60		26.60	38.60	13.31
	Outward	2.60	2.70	2.60		0.30	2.90	
Lithuania	Inward	17.60	25.00	19.00		20.40	38.30	9.34
	Outward	5.80	3.90	5.90		0.30	4.10	
Luxembourg	Inward	75.00	369.50	–398.80			60.20	0.31
	Outward	116.30	47.00	564.60			191.90	
Hungary	Inward	30.70	27.70	19.30	1.50	47.70	70.50	5.34
	Outward	8.80	14.80	14.20	0.40	2.70	13.20	
Malta	Inward	58.70	150.00	69.30	18.90	61.30	100.70	6.41
	Outward	–1.80	0.00	1.40		5.20	15.70	
Germany	Inward	8.60	10.50	8.30	6.50	14.30	19.00	0.51
	Outward	14.20	18.10	27.20	8.80	28.50	37.30	
Italy	Inward	5.40	10.10	9.10	5.30	11.00	17.30	0.70
	Outward	11.40	10.80	20.50	5.30	16.40	24.70	
Portugal	Inward	9.40	26.10	11.40	14.00	28.40	51.20	1.64
	Outward	5.00	16.10	12.60	1.20	17.60	31.10	
Romania	Inward	28.50	40.10	25.50	0.00	18.80	36.70	61.16
	Outward	–0.10	1.50	–0.20	0.20	0.40	0.60	
Spain	Inward	7.60	7.20	11.90	12.70	26.90	37.40	0.84
	Outward	12.70	26.80	26.80	3.00	28.90	44.30	
Sweden	Inward	16.00	32.60	24.30	5.20	38.30	56.00	0.82
	Outward	41.70	30.90	43.80	20.90	50.20	67.80	
Slovakia	Inward	16.60	28.40	16.70	–	23.30	53.60	25.50
	Outward	1.20	2.50	2.00	–	1.80	2.10	
Slovenia	Inward	6.40	6.50	10.80	–	14.80	22.50	1.69
	Outward	7.20	9.00	11.90	–	3.90	13.30	

Source: UNCTAD (2008)

Table A.10 Clusters based on the driving factors of the crisis

Description of the clusters							
	1	2	3	4	5	6	Total
Number of the countries	*n* = 8	*n* = 7	*n* = 1	*n* = 3	*n* = 8	*n* = 1	*n* = 28
Cumulated losses/gains of GDP 2009–2013 comparing to 2008, at constant prices in the share of 2008 GDP[a]							
Mean	–0.05	–0.24	–0.30	0.13	–0.37	–0.09	–0.18
Std. Deviation	0.14	0.22	0.00	0.28	0.16	0.00	0.24
Current account balance in % of GDP—2008[b]							
Mean	2.98	–8.31	–5.60	–4.97	–11.41	5.40	–5.03
Std. Deviation	4.33	6.38	0.00	2.49	5.43	0.00	7.74
House price index (2010 = 100) % change T/T–3, T = 2011[b]							
Mean	1.36	–5.64	–38.70	–10.07	–25.23	8.00	–10.40
Std. Deviation	9.17	7.99	0.00	6.49	12.73	0.00	15.34
Private debt in % of GDP—consolidated—2008[b]							
Mean	168.76	173.23	256.50	67.40	114.26	399.00	154.80
Std. Deviation	43.90	50.87	0.00	1.05	28.76	0.00	73.23
General government gross debt in % of GDP 2008[b]							
Mean	55.66	71.41	44.20	34.57	23.99	14.40	46.41
Std. Deviation	19.29	28.27	0.00	10.86	21.14	0.00	28.09
Inward FDI stocks in % of GDP 2008[b]							
Mean	73.00	36.64	75.10	49.77	50.50	2911.50	156.44
Std. Deviation	48.67	19.63	0.00	10.11	22.11	0.00	540.90
Gross value added—Industry, including energy, % of all branches—2008[b]							
Mean	21.23	15.37	23.60	27.63	21.70	9.40	20.25
Std. Deviation	3.19	3.57	0.00	2.90	3.77	0.00	5.29
Gross value added—Business activities and financial services, % of all branches—2008[b]							
Mean	25.46	26.81	28.80	18.10	21.70	52.20	25.01
Std. Deviation	3.34	5.15	0.00	1.25	3.77	0.00	7.07

Description of the clusters							
	1	2	3	4	5	6	Total
Number of the countries	*n* = 8	*n* = 7	*n* = 1	*n* = 3	*n* = 8	*n* = 1	*n* = 28
Average value of imports and exports of goods divided by GDP (%) 2008[b]							
Mean	44.99	22.70	38.40	56.13	49.59	44.90	41.69
Std. Deviation	12.24	3.57	0.00	20.69	14.16	0.00	16.26
Average value of imports and exports of services divided by GDP (%) 2008[b]							
Mean	16.59	10.70	39.80	8.20	12.00	97.70	16.63
Std. Deviation	10.13	7.72	0.00	1.80	3.51	0.00	18.16
Labour productivity per person employed 2008, EU-27 = 100[b]							
Mean	111.64	100.34	126.90	71.93	62.95	168.20	93.21
Std. Deviation	9.42	14.61	0.00	8.82	14.73	0.00	28.60
Real effective exchange rate—42 trading partners—% change T/T–3, T = 2008[b]							
Mean	1.20	0.57	7.30	20.93	10.76	3.40	6.19
Std. Deviation	2.48	5.33	0.00	5.71	6.31	0.00	8.18
Total bank assets to GDP (%) 2008[c]							
Mean	387.48	370.05	960.63	91.94	117.27	3403.09	402.43
Std. Deviation	151.31	169.39	0.00	17.01	34.33	0.00	626.74
Total recapitalisation and asset relief 2008–2012, as a % of 2012 GDP[d]							
Mean	3.49	7.40	39.96	0.00	0.82	5.85	4.72
Std. Deviation	3.64	6.30	0.00	0.00	1.57	0.00	8.26

Source:
[a]Author's own calculation by AMECO
[b]Eurostat
[c]European Central Bank online database
[d]European Commission (2014g)

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